

NABE Outlook

Economic Expansion Is Firmly on Track

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For further information contact:

Technical | **Richard DeKaser** 202-306-9814

William Strauss 312-322-8151

Lynn Reaser 619-849-2690

Media | **Melissa Golding** 571-236-2820

*The February 2010 NABE Outlook presents the consensus of macroeconomic forecasts made by a panel of 48 professional forecasters. (See last page for listing.) The survey, covering the outlook for 2010 and 2011, was conducted from January 22 through February 4. The NABE Outlook originated in 1965 and is one of three surveys conducted 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 those who use economics in their work. NABE has 2,300 members and 31 chapters nationwide. **Richard DeKaser**, Woodley Park Research; **Parul Jain**, MacroFin Analytics; **Robert Kleinhenz**, California Association of Realtors; **Charles Steindel**, Federal Reserve Bank of New York; and **William Strauss**, Federal Reserve Bank of Chicago, 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 a proper citation to NABE.*

SUMMARY: The expansion is on track for a resumption of job gains in the near term and sustained growth over the next two years that will slightly exceed the economy's trend pace. NABE panelists characterize the outlook as largely a traditional economic recovery—with sizable gains in discretionary spending by businesses and households—though still restrained by past wealth losses and excessive indebtedness. “We see a healthy expansion under way, although it will take time to reduce economic slack and repair damaged balance sheets,” said NABE President **Lynn Reaser**, chief economist at Point Loma Nazarene University.



Highlights

- **The NABE forecast panel expects the economic recovery to remain firmly on track.** Real GDP growth of 3.1 percent is projected over the four quarters of 2010, nearly identical to last November's prediction of 3.2 percent. That pace is also expected for 2011, comparing favorably with the panel's 2.7 percent assessment of the economy's underlying trend.
- **The consensus regarding growth in 2010 has narrowed,** with the more optimistic forecasts being trimmed and the more pessimistic ones being lifted. The dispersion among forecasters (as measured by the standard deviation of predictions on a Q4/Q4 basis) tightened to 0.9 percentage point from 1.1 percentage point.
- When asked to qualitatively characterize the economic recovery, panelists ascribed to no dominant view but suggested a variety of characterizations. The most popular view, by a small margin, describes the outlook as a traditional economic expansion in its early phase, with above-trend growth and gradually firming inflationary pressures. Only nine of the panelists firmly hold this position, however. Many NABE panelists fear that financial headwinds will hold growth short of what might typically be expected. Very few foresee a "stagflation" scenario—blending of slow growth and high inflation—with none regarding this scenario as very likely.
- While "financial headwinds" are expected to remain problematic, they are also likely to abate. **Specifically, bank lending is expected to become less restrictive over the course of 2010,** as bank earnings and economic conditions improve, according to 70 percent of respondents. Thirty percent, alternatively, believe conditions will remain restrictive due to regulatory guidance, capital pressures and a general climate of risk aversion.
- **The panel continues to view the household sector as relatively sluggish.** Real consumer spending is predicted to rise just 2.2 percent this year before gaining 2.8 percent in 2011. Consistent with recent NABE survey results, the panelists mostly attribute lackluster American consumer spending to past wealth losses and initially modest employment gains.
- Despite scant confirmation thus far, **NABE panelists are sticking with their November prediction of an end to the jobless recovery.** The median forecast is for an average monthly increase of 50,000 jobs during the first quarter of 2010, up from November's forecast of no net change. For the year as a whole, the forecast is essentially unchanged; the latest prediction of an average monthly gain of 103,000 is close to November's prediction of 116,000. Similarly, the jobless rate is expected to decline to 9.6 percent by the fourth quarter, comparable to November's prediction of 9.5 percent.
- The dominant view is that **the saving rate is approaching a peak.** The median prediction for 2010 was 4.8 percent, compared with a 4.6 percent rate during the final quarter of 2009. NABE panelists also anticipate a substantial gain in vehicle sales to 12.0 million units this year and 13.6 million units in 2011. While modest by historical standards, sales at these levels still represent large gains over a deeply depressed 2009.
- **The housing market rebound is considered ongoing and sustainable.** Home prices are predicted to rise 1.6 percent this year and 2.6 percent further in 2011. Such increases would barely keep up with inflation (more below), but nonetheless mark an important watershed for the economy. Housing starts and the broader measure of housing activity—residential investment—are each expected to show substantial gains going forward. As with vehicle sales, the overall level of activity will remain modest by historical standards, but represent a material improvement over 2009.
- In keeping with the constructive housing market outlook, NABE panelists feel strongly—by a 7-to-1 majority—that **the Federal Reserve will conclude its purchase of mortgage-backed securities in March,** as is presently scheduled. They also believe that the program's completion will have a moderate effect on mortgage interest rates; three-quarters of panelists believe mortgage interest rates will increase 50 basis points or less.

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- In contrast with the sluggish household sector, **businesses are expected to play a vital role in the early stage of the economic expansion.** The prediction for real spending on software and equipment has been marked up from November's outlook—to a robust gain of 7.2 percent in 2010, with a further gain of 8.6 percent in 2011. Inventory rebuilding is also expected to contribute to growth after the steep 2008-2009 slide. An important exception applies to nonresidential building, where the downturn has further to go. After last year's precipitous decline of 19.7 percent, a further drop of 10.8 percent is in store for this year. Next year should see an end to the collapse, with no change overall.
- In part, the general rise in business investment will reflect strong gains in corporate profits—up 24 percent over the next two years. Consistent with the profit outlooks, NABE panelists predict an improving stock market over the forecast horizon, with the S&P 500 Index up 23 percent overall. **Not a single forecaster is predicting a decline in stock market values.**
- Government spending will grow slowly over the next two years, though surely more than it would have absent the American Recovery and Reinvestment Act of 2009. At the same time, panelists expect the federal deficit to remain very high. At \$1.40 trillion for this fiscal year, NABE panelists' views are on a par with deficit predictions from the Congressional Budget Office (\$1.35 trillion) though more optimistic than the administration's Office of Management and Budget (\$1.56 trillion). The deficit for the next fiscal year is expected to abate somewhat, to \$1.18 trillion—lower than the White House's prediction (\$1.27 trillion), but higher than that of the CBO (\$980 billion). **Among 14 potential economic challenges, NABE panelists identified federal debt as the most concerning.**
- **Foreign trade will remain neutral over the forecast horizon.** Some drag related to foreign trade is expected over the near-term as domestic inventory rebuilding adds to the demand for imports. This lost ground will be recovered in 2011, however, as global growth and a still-weak currency improve net exports. On a year-end to year-end basis, the exchange rate is expected to be unchanged, in relation to both the Euro and the Federal Reserve's trade-weighted index. Despite huge concerns surrounding the magnitude of federal debt going forward, NABE panelists registered only modest concerns about the risk of a falling dollar.
- **Inflation will remain subdued,** with the "core" PCE deflator (the Fed's preferred measure, which measures consumer price trends excluding food and energy) advancing just 1.5 percent this year and 1.7 percent in 2011. Critical to this low inflation environment are expectations that unit labor costs will show no net increase over the forecast horizon. This is one area, however, where the median view of the NABE panel conceals a wider dispersion. One-quarter of survey respondents expect the core PCE deflator's rise to surpass 2.1 percent by 2011, which would exceed the preferences of at least some members of the Fed's Open Market Committee. Also, when asked about economic challenges over the next five years, respondents rated "inflation" as more of a concern than "deflation."
- **Interest rates will remain low.** The Federal Reserve is expected to begin to raise the federal funds rate late in the third quarter, followed by a series of increases at a "measured" pace. At 1.5 percent during the second quarter of 2011, the federal funds rate will still be negative in "real" terms, as it will be lower than expected inflation. The 10-Year Treasury Note will also see its yield drift upward, albeit only slightly, to 4.5 percent by the second quarter of 2011. That is less than one percentage point over the current level.
- **NABE panelists are concerned that the Fed will be slow to remove the "punch bowl."** As noted above, they rank the risk of "inflation" to be substantially greater than "deflation" over the next five years despite a considerable degree of economic slack. Also, when asked specifically to assess the risk of the Fed moving "too slowly" or "too quickly" to remove monetary stimulus, respondents tilted 60%-40% in the direction of "too slowly."

Table 1 Comparative Surveys Median Forecast Reported

	Actual	Forecasts				
	2009	2010				2011
		May 09 Survey	Oct 09 Survey	Nov 09 Survey	Feb 10 Survey	Feb 10 Survey
Real Gross Domestic Product, % change, Q4/Q4	0.1	2.7	3.0	3.2	3.1	3.1
Real Gross Domestic Product, % change, annual average	-2.4	2.0	2.6	2.9	3.1	3.2
Personal Consumption Expenditures, % change	-0.6	2.1	1.6	2.0	2.2	2.8
Nonresidential Structures, % change	-19.7	-5.1	-4.9	-7.3	-10.8	0.0
Nonresidential Equipment and Software, % change	-16.9	-0.3	2.4	4.2	7.2	8.6
Residential Investment, % change	-20.4	5.1	8.3	9.0	8.0	14.3
Change in Business Inventories, billions of chained 2000\$	-111.7	10.0	10.5	10.0	20.8	44.2
Net Exports, billions of chained 2000\$	-353.8	-345.2	-361.8	-369.3	-356.0	-366.0
Exports, % change	-9.9	2.0	5.1	6.5	10.1	7.5
Imports, % change	-14.2	3.9	4.4	5.6	8.1	6.9
Government Consumption Expenditures & Gross Investment, % change	1.9	2.5	2.0	2.1	2.0	1.5
Implicit GDP Deflator, % change	1.2	1.3	1.3	1.4	1.1	1.7
Trade Balance Goods & Services, BoP basis, \$ billions	-380.7	-525.0	-475.7	-480.0	-471.5	-490.0
Foreign Exchange Rate, US\$ per Euro, December average	1.46	1.34	1.44	1.47	1.4	1.4
Trade-Weighted Value of the US\$, FRB						
Broad Index, December average	101.8	106.5	101.0	100.0	100.9	100.9
Consumer Price Index, % change, annual average	-0.3	1.7	1.8	1.8	2.1	2.1
Consumer Price Index, % change, Q4/Q4	1.5	1.8	1.8	1.5	1.8	2.1
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.4	1.5	1.5	1.5	1.5	1.7
Nonfarm Employment, average monthly change, thousands	-347	105	107	112	113	200
Nonfarm Business Compensation Per Hour, % change	2.0	2.9	2.2	2.3	2.7	2.5
Nonfarm Business Output Per Hour, % change	2.9	2.3	2.5	2.8	3.4	2.0
Federal Funds Target, % year-end	0.125	1.000	1.000	1.000	0.725	2.25
10-Year Treasury Note Yield, % year-end	3.85	3.80	4.30	4.15	4.25	4.75
Federal Deficit, FY, unified, \$ billions	-1417	-1384	-1300	-1314	-1396	-1177
Corporate Profits After Tax, % change*	na	7.1	11.2	12.4	15.0	7.5
Civilian Unemployment Rate, % annual average	9.3	9.6	9.8	9.8	9.9	9.2
Industrial Production, % change	-9.7	2.1	3.4	4.1	4.9	4.5
Light Vehicle Sales, millions of units	10.4	11.9	12.0	11.6	12.0	13.6
Housing Starts, millions of units	0.55	0.84	0.80	0.79	0.73	1.00
Home Prices, FHFA, % change, Q4/Q4	na	1.0	2.0	2.0	1.6	2.6
Oil Prices, \$ per barrel, December average	74	65	75	80	80	84
S&P 500 Index, December 31	1115	1090	1180	1199	1200	1325

Historical data from Haver Analytics (1/29/10); forecasts from NABE

Quarterly Forecasts

Survey:	GDP % change, annual rate		Unemployment Rate %		Nonfarm Employment in thousands, average monthly change		PCE Price Index, ex Food & Energy, % change, annual rate	
	11/09	2/10	11/09	2/10	11/09	2/10	11/09	2/10
Q1-10	3.0	3.0	10.0	10.1	0	50	1.4	1.3
Q2-10	3.1	3.0	10.0	10.0	115	108	1.4	1.4
Q3-10	3.2	3.0	9.8	9.9	151	89	1.6	1.5
Q4-10	3.3	3.2	9.6	9.6	200	167	1.7	1.6
Q1-11	na	3.3	na	9.5	na	197	na	1.7
Q2-11	na	3.3	na	9.2	na	200	na	1.6

Survey:	Fed Funds Target % quarter-end		10-Year Treasury Note Yield % quarter-end	
	11/09	2/10	11/09	2/10
Q1-10	0.125	0.125	3.65	3.79
Q2-10	0.225	0.125	3.78	3.95
Q3-10	0.500	0.250	4.00	4.07
Q4-10	1.000	0.750	4.18	4.25
Q1-11	na	1.200	na	4.40
Q2-11	na	1.500	na	4.51

Table 2 Distribution of Selected Responses**Annual Forecasts**

	2010 Forecast			2011 Forecast		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Real Gross Domestic Product, % change, Q4/Q4	3.1	1.3	4.3	3.1	2.1	4.6
Consumer Price Index, % change, Q4/Q4	1.8	1.0	2.9	2.1	0.8	3.5
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.5	0.6	3.0	1.7	0.8	2.6
Civilian Unemployment Rate, % annual average	9.9	9.2	10.5	9.2	8.0	10.1
Federal Funds Target, % year-end	0.725	0.124	2.050	2.250	0.242	4.070
10-Year Treasury Note Yield, % year-end	4.25	3.45	4.86	4.75	3.76	5.69
Foreign Exchange Rate, US\$ per Euro, December average	1.40	1.18	1.51	1.39	1.22	1.53
Housing Starts, millions of units	0.73	0.58	1.01	1.00	0.65	1.38
Home Prices, FHFA, % change, Q4/Q4	1.6	-4.1	5.0	2.6	-0.4	4.6
Oil Prices, \$ per barrel, December average	80.0	67.8	91.6	83.9	65.9	99.0
S&P 500 Index, December 31	1200	1152	1443	1325	1175	1648

Quarterly Forecasts

	Real Gross Domestic 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
Q1-10	3.0	1.8	5.0	10.1	9.7	10.4	50	-73	169
Q2-10	3.0	1.5	5.0	10.0	9.4	10.4	108	-13	339
Q3-10	3.0	1.3	4.9	9.9	9.1	10.6	89	-22	260
Q4-10	3.2	1.2	4.6	9.6	8.7	10.5	167	52	287
Q1-11	3.3	1.9	4.4	9.5	8.5	10.3	197	63	292
Q2-11	3.3	1.9	4.7	9.2	8.2	10.2	200	72	327

	Personal Consumption Expenditures Price Index (PCE) less food & energy % quarter-end			Fed Funds Target % quarter-end			10-Year T-Note Yield % quarter-end		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Q1-10	1.3	0.7	4.4	0.125	0.119	0.220	3.79	2.77	4.04
Q2-10	1.4	0.6	3.1	0.125	0.124	0.550	3.95	2.77	4.43
Q3-10	1.5	0.4	3.1	0.250	0.124	1.280	4.07	2.84	4.63
Q4-10	1.6	0.5	2.8	0.750	0.124	1.950	4.25	2.89	4.88
Q1-11	1.7	0.6	2.6	1.200	0.130	2.478	4.40	3.03	5.00
Q2-11	1.6	0.6	2.7	1.500	0.180	3.100	4.51	3.09	5.16

Five highest and five lowest are the response averages

With their permission, NABE panelists who responded to the February 2010 NABE Outlook survey are:

Michael R. Englund, Action Economics, LLC

Thomas K. Swift, American Chemistry Council

Chris Rupkey, Bank of Tokyo-Mitsubishi UFJ

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

Jonathan Oxborrow, Caterpillar Inc.

Bill Watkins / Dan Hamilton, Center for Economic Research and Forecasting, California Lutheran University

Constantine G. Soras, CGS Economic Consulting

Esmael Adibi, Chapman University

Chris Chmura / Xiaobing Shuai, Chmura Economics & Analytics

Ken Mayland, ClearView Economics, LLC

Jan Reid, Coast Economic Consulting

Robert Fry, DuPont

Susan M. Sterne, Economic Analysis Associates, Inc.

Douglas Lee, Economics from Washington

Doug Duncan, Fannie Mae

Michael R. Paslawskyj, Federal Deposit Insurance Corporation

Brian Wesbury / Robert Stein, First Trust Advisors

Emily Kolinski Morris, Ford Motor Company

Rajeev Dhawan, Georgia State University

Gary Ciminero, GLC Financial Economics

US Economics Research, Goldman Sachs

John D. Herrmann, Herrmann Forecasting LLC

Margaret McCarthy / Jeff Werling, Inforum, Univ. of Maryland

John Pope, Investment Economics

Richard Rippe, ISI Group

Sandy Batten / Robert Mellman, J.P. Morgan

Bill Cheney, John Hancock Financial

Jim Glassman, JPMorgan Chase & Co

Jack Kleinhenz, Kleinhenz & Associates, Inc.

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Macroeconomic Advisers

Parul Jain, MacroFin Analytics

Diane Swonk, Mesirow Financial

Mark Zandi, Moody's Economy.com

Joel L. Naroff, Naroff Economic Advisors

David Resler, Nomura Securities International, Inc.

James F. Smith, Parsec Financial Management

David W. Berson, PMI Group

Stuart Hoffman, PNC Financial Services

Lynn Reaser, Point Loma Nazarene University

Lyle Gramley, Potomac Research Group

Saul H. Hymans, RSQE, University of Michigan

Stephen Gallagher, Societe Generale

Kurt Karl, Swiss Re

Jeff Thredgold, Thredgold Economic Associates

Charles Devlin, UPMC

Martin Regalia, US Chamber of Commerce

John Silvia, Wells Fargo

Richard DeKaser, Woodley Park Research

