

NABE Outlook

U.S. Recovery Approaches One-Year Anniversary in Good Shape

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*The May 2010 NABE Outlook presents the consensus of macroeconomic forecasts from a panel of 46 professional forecasters. (See last page for listing.) The survey, covering the outlook for 2010 and 2011, was taken April 27 – May 7. 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 32 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: NABE panelists marked up their predictions for economic growth in 2010 and expect performance to exceed its long-term trend this year and next. “Although risks involving Europe have recently escalated, the outlook in this country has improved in most respects. Growth prospects are stronger, unemployment and inflation are lower, and worries relating to consumer retrenchment and domestic financial headwinds have diminished,” said NABE President **Lynn Reaser**, chief economist at Point Loma Nazarene University. “The economy is in reasonably good shape as the recovery approaches its first anniversary, but forecasters remain ‘extremely’ concerned about large federal deficits going forward.”



Highlights

- **The NABE forecast panel has boosted its expectations for growth in 2010** to 3.2 percent for real GDP from 3.1 percent in its February forecast. The panel is also predicting a 3.2 percent pace of real GDP growth for 2011, meaning a sustained two-year stretch in excess of the economy's potential—or “trend”—rate of growth. The panel estimates the economy's potential rate of growth at 2.8 percent over the next five-year period. **NABE panelists date the expansion as nearly one year old**, with the trough of the previous recession in June of 2009.
- **Many of the forecasters believe that the traditional cyclical forces of pent-up demand and inventory building are becoming more important. Although financial headwinds will temper the pace of growth, concerns about credit conditions have eased somewhat compared to February's survey. Inflationary pressures are expected to gradually build**, but a “stagflation” scenario—a combination of slow growth and high inflation—is considered highly unlikely.
- **The biggest boost to the outlook comes from households**, as forecasters have marked up their outlook for spending. Real consumer spending is still expected to lag behind the overall economy but should see sizable growth. Part of this mark-up reflects reduced expectations of thrift. The saving rate for 2010 is currently expected to average a modest 3.4 percent—down from the 4.6 percent rate predicted just three months ago.
- **Job growth is now on a steady footing.** Except for a third-quarter slowdown related to a reversal of Census-related hiring, job gains are expected to remain robust throughout the forecast horizon, as output gains remain steady but productivity gains progressively slow. The jobless rate is forecast to steadily decline to 9.4 percent by year-end 2010 and 8.5 percent by year-end 2011, though it remains high by historical standards and is ranked by panelists as their second greatest “concern.” **Additionally, NABE panelists increased their estimate of the unemployment rate consistent with full employment to 5.5 percent** from 5.0 percent previously.
- **Setbacks to the housing recovery early this year surprised most forecasters, and the strength of the rebound has also been downgraded.** Previous NABE surveys showed expectations that housing would be a growth sector—exceeding the pace of the economy overall. In the current survey, it is expected to play more of a supporting role in 2010. Nonetheless, residential investment and housing starts are forecast to continue to rise throughout the forecast horizon. Last year's lows in home sales and home prices will not be retested, according to 65 percent of survey respondents, and the rebound is intact.
- **Business investment will be an engine of growth driving the economic recovery.** First, the massive inventory liquidation of 2008-2009 is over, with restocking slated for the next two years. Second, business spending on equipment and software will be strong, likely buoyed by a combination of higher operating rates and rising corporate profits. Business spending on structures, however, will continue to decline, albeit at a slower pace than during the free-fall of 2009.
- **Smaller businesses should see some easing of credit conditions going forward**, according to three-quarters of survey respondents. One-quarter expect no change, but none expect credit availability to deteriorate.
- **Corporate profits will post a solid 20 percent gain in 2010 with an additional 7 percent rise in 2011**, slightly better than usual for this stage of an economic recovery. Despite the stock market rally over the past year, NABE panelists still remain optimistic. While opinions differ on the magnitude of the stock market rebound, all but one forecaster expect an increase in 2010. All expect further gains in 2011.

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- **The dollar will retain much of its recent gains** vis-à-vis both the euro and a trade-weighted basket of foreign currencies. With respect to the risk of a Greek default, views are mixed. Fifty-one percent believe that a default will not occur, though some debt restructuring will be required. Twelve percent expect outright default within the next twelve months and 37 percent expect default after some short-term maneuvering only buys time. (It should be noted that these responses were collected prior to the May 9 announcement by the EU, IMF, and ECB of the program to address the European financial crisis.) As for China, forecasters assigned a 30 percent probability to it presently experiencing a “bubble,” though there was a wide dispersion on this. The top quartile assigned a 60 percent probability of a bubble, while the bottom quartile assigned only a 20 percent probability.
- **Foreign trade will grow rapidly, due to strong economic growth worldwide and easier financing conditions.** The trade deficit is expected to widen slightly in both nominal and real terms. Relative to real GDP, the trade deficit will remain steady, meaning that net foreign trade will be neutral over the forecast horizon.
- **Government spending will advance at an anemic 0.7 percent pace in 2010**, and by a still modest 1.2 percent in 2011 due to persistent fiscal stress at the state and local levels and the winding down of federal stimulus spending legislated in 2009. Regarding the federal debt, 60 percent of survey respondents are “extremely concerned” about its implications over the next five years, outranking, by a wide margin, all other factors considered.
- **Inflation will remain low**, most likely because of persistent economic slack. Labor productivity gains, while slowing, will still outpace compensation, resulting in falling unit labor costs in 2010. In fact, inflation forecasts have been trimmed somewhat since the February survey. The NABE panel expects the **core PCE deflator** (personal consumption expenditures price index excluding food and energy) to rise just 1.3 percent this year. That figure resides precisely in the “central tendency” of the Federal Reserve’s January Open Market Committee (FOMC) forecasts. NABE’s forecast of the PCE core deflator for 2011 is toward the high end of the Federal Reserve’s central tendency, at 1.7 percent. Despite this generally sanguine near-term outlook, panelists are more concerned for the future about higher rather than lower inflation. “Inflation” scored 2.8 on the 1-to-5 scale of concerns over the next five years, whereas “deflation” ranked just 1.6 on that same scale.
- **Reduced inflation expectations prompted the NABE panel to push back its forecast for monetary tightening**, measured by increases in the federal funds interest rate. The first interest rate increase by the FOMC is now slated for the fourth quarter of 2010, with the fed funds rate at 0.5 percent by year-end. This compares with a 0.75 percent rate in the February forecast. Rate hikes are expected to continue into next year, with the target hitting 2.0 to 2.5 percent by year-end 2011. This “more patient” Fed outlook, combined with reduced inflation expectations, is also reflected in a slightly lower interest rate for the 10-year Treasury note over the near-term. By the middle of next year, however, the yield on the 10-Year T-note is still expected to reach 4.5 percent.

Table 1 Comparative Surveys Median Forecast Reported

	Actual	Forecasts				
	2009	2010			2011	
		Nov 09 Survey	Feb 10 Survey	May 10 Survey	Feb 10 Survey	May 10 Survey
Real Gross Domestic Product, % change, Q4/Q4	0.1	3.2	3.1	3.2	3.1	3.2
Real Gross Domestic Product, % change, annual average	-2.4	2.9	3.1	3.2	3.2	3.2
Personal Consumption Expenditures, % change	-0.6	2.0	2.2	2.6	2.8	2.8
Nonresidential Structures, % change	-19.8	-7.3	-10.8	-12.6	0.0	-1.1
Nonresidential Equipment and Software, % change	-16.6	4.2	7.2	10.7	8.6	11.0
Residential Investment, % change	-20.5	9.0	8.0	1.9	14.3	12.6
Change in Business Inventories, billions of chained 2000\$	-108.2	10.0	20.8	35.0	44.2	49.4
Net Exports, billions of chained 2000\$	-355.6	-369.3	-356.0	-370.0	-366.0	-377.5
Exports, % change	-9.6	6.5	10.1	10.2	7.5	7.4
Imports, % change	-13.9	5.6	8.1	9.0	6.9	7.5
Government Consumption Expenditures & Gross Investment, % change	1.8	2.1	2.0	0.7	1.5	1.2
Implicit GDP Deflator, % change	1.2	1.4	1.1	1.0	1.7	1.6
Trade Balance Goods & Services, BoP basis, \$ billions	-378.6	-480.0	-471.5	-448.3	-490.0	-473.3
Foreign Exchange Rate, US\$ per Euro, December average	1.46	1.47	1.40	1.29	1.39	1.29
Trade-Weighted Value of the US\$, FRB Broad Index, December average	101.8	100.0	100.9	102.9	100.9	103.0
Consumer Price Index, % change, annual average	-0.3	1.8	2.1	2.0	2.1	2.0
Consumer Price Index, % change, Q4/Q4	1.5	1.5	1.8	1.6	2.1	2.1
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.5	1.5	1.5	1.3	1.7	1.7
Nonfarm Employment, average monthly change, thousands	-395	112	113	120	200	225
Nonfarm Business Compensation Per Hour, % change	1.9	2.3	2.7	2.2	2.5	2.5
Nonfarm Business Output Per Hour, % change	3.7	2.8	3.4	3.5	2.0	2.0
Federal Funds Target, % year-end	0.125	1.000	0.725	0.500	2.250	2.000
10-Year Treasury Note Yield, % year-end	3.85	4.15	4.25	4.18	4.75	4.73
Federal Deficit, FY, unified, \$ billions	-1413	-1314	-1396	-1310	-1177	-1123
Corporate Profits After Tax, % change*	-4.9	12.4	15.0	20.0	7.5	7.0
Civilian Unemployment Rate, % annual average	9.3	9.8	9.9	9.6	9.2	9.0
Industrial Production, % change	-9.7	4.1	4.9	5.2	4.5	4.6
Light Vehicle Sales, millions of units	10.4	11.6	12.0	11.7	13.6	13.3
Housing Starts, millions of units	0.55	0.79	0.73	0.68	1.00	0.95
Home Prices, FHFA, % change, Q4/Q4	-4.7	2.0	1.6	0.7	2.6	2.5
Oil Prices, \$ per barrel, December average	74	80	80	84	84	89
S&P 500 Index, December 31	1115	1199	1200	1235	1325	1305

Historical data from Haver Analytics (5/18/10); forecasts from NABE

Quarterly Forecasts

Survey:	GDP % change, annual rate		Civilian Unemployment Rate % Quarterly Average		Nonfarm Employment in thousands, average monthly change		PCE Price Index, ex Food & Energy, % change, annual rate	
	2/10	5/10	2/10	5/10	2/09	5/10	2/10	5/10
Q1-10	3.0	3.2 ^a	10.1	9.7 ^a	50	94 ^a	1.3	0.6 ^a
Q2-10	3.0	3.0	10.0	9.6	108	149	1.4	1.2
Q3-10	3.0	3.2	9.9	9.5	89	84	1.5	1.3
Q4-10	3.2	3.3	9.7	9.4	167	198	1.5	1.4
Q1-11	3.3	3.1	9.5	9.2	197	200	1.7	1.5
Q2-11	3.3	3.3	9.2	9.1	200	225	1.6	1.5
Q3-11	na	3.2	na	8.8	na	225	na	1.5
Q4-11	na	3.3	na	8.5	na	200	na	1.6

Survey:	Fed Funds Target % quarter-end		10-Year Treasury Note Yield % quarter-end	
	2/10	5/10	2/10	5/10
Q1-10	0.125	0.125 ^a	3.79	3.84 ^a
Q2-10	0.125	0.125	3.95	3.85
Q3-10	0.250	0.128	4.07	3.98
Q4-10	0.750	0.500	4.25	4.20
Q1-11	1.200	1.000	4.40	4.34
Q2-11	1.500	1.468	4.51	4.50
Q3-11	na	1.849	na	4.60
Q4-11	na	2.362	na	4.85

a = actual

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	3.2	2.3	4.2	3.2	1.9	4.6
Consumer Price Index, % change, Q4/Q4	1.6	0.8	3.1	2.1	0.9	4.0
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.3	-0.1	2.4	1.7	0.6	2.7
Civilian Unemployment Rate, % annual average	9.6	9.1	9.9	9.0	7.9	9.6
Federal Funds Target, % year-end	0.5	0.1	1.5	2.0	0.5	3.8
10-Year Treasury Note Yield, % year-end	4.2	3.6	4.7	4.7	4.1	5.4
Foreign Exchange Rate, US\$ per Euro, December average	1.29	1.18	1.39	1.29	1.14	1.49
Housing Starts, millions of units	0.68	0.59	0.91	0.95	0.66	1.25
Home Prices, FHFA, % change, Q4/Q4	0.7	-4.6	3.9	2.5	-0.5	5.0
Oil Prices, \$ per barrel, December average	84.0	68.2	92.7	88.8	70.3	95.4
S&P 500 Index, December 31	1235	1115	1392	1305	1184	1504

Quarterly Forecasts

	Real Gross Domestic Product, % change, annual rate			Civilian Unemployment Rate % Quarterly Average			Nonfarm Employment in thousands, average monthly change		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Q1-10	3.2 ^a	na	na	9.7 ^a	na	na	94 ^a	na	na
Q2-10	3.0	1.8	4.9	9.6	9.4	9.9	149	1	304
Q3-10	3.2	1.6	4.5	9.5	9.1	10.0	84	-7	289
Q4-10	3.3	1.2	4.8	9.4	8.7	9.9	198	57	316
Q1-11	3.1	1.4	5.0	9.2	8.4	9.8	200	70	341
Q2-11	3.3	1.8	5.4	9.1	8.1	9.7	225	77	331
Q3-11	3.2	1.9	5.0	8.8	7.9	9.5	225	85	332
Q4-11	3.3	1.8	5.1	8.5	7.6	9.5	200	91	332

	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	0.6 ^a	na	na	0.125 ^a	na	na	3.84 ^a	na	na
Q2-10	1.2	0.5	2.9	0.125	0.076	0.320	3.85	3.60	4.21
Q3-10	1.3	0.2	2.6	0.128	0.080	0.775	3.98	3.74	4.42
Q4-10	1.4	0.0	2.7	0.500	0.080	1.375	4.20	3.83	4.67
Q1-11	1.5	-0.1	2.6	1.000	0.140	1.910	4.34	3.92	4.91
Q2-11	1.5	0.4	2.8	1.468	0.275	2.375	4.50	3.98	5.04
Q3-11	1.5	0.7	2.8	1.849	0.625	3.000	4.60	4.02	5.20
Q4-11	1.6	0.8	2.9	2.362	0.825	3.750	4.85	4.08	5.40

Five highest and five lowest are the response averages

a = actual

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

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