NABE Economic Policy Survey
National Association For Business Economics

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EMBARGOED UNTIL:
Monday, March 24, 2003
9:45 AM Eastern

NOTE: THE SURVEY RESULTS WILL BE RELEASED AT A PRESS CONFERENCE AT 9:45 AM ON MONDAY, MARCH 24, 2003, IN THE WILLIAMSBURG ROOM, WATERGATE HOTEL, 2650 VIRGINIA AVE, WASHINGTON, DC, DURING THE NABE ECONOMIC POLICY CONFERENCE. THE TWO-DAY CONFERENCE FEATURES TREASURY SECRETARY JOHN SNOW, SEC CHAIR WILLIAM DONALDSON, AND OTHER LEADERS FROM THE PUBLIC AND PRIVATE SECTORS. REGISTRATION IS COMPLIMENTARY FOR WORKING PRESS. PROGRAM AT WWW.NABE.COM.

NABE Panel: War and Domestic Security Are Biggest Threats Facing U.S. Economy

March 2003

The NABE Economic Policy Survey presents the consensus of a panel of 223 members of the National Association for Business Economics. Conducted semiannually, this survey was taken March 3-10, 2003. May be reprinted in whole or in part with credit given to NABE. View the survey results, including complete tabulations, online at www.nabe.com. This is one of three surveys conducted by NABE. The other two are the NABE Outlook and the NABE Industry Survey. ***Laurie Matthias*** *of Capital Guardian Trust Company conducted the analysis for this report.*

"Geopolitical risks – war in Iraq and domestic security – currently constitute the biggest threat to the U.S. economy, according to the latest canvass of NABE members on policy issues," says **Tim O'Neill**, President of NABE and Chief Economist, BMO Financial Group. "The NABE panel is also concerned about corporate governance – more regulation is needed as recent changes have not been sufficient to boost confidence in U.S. financial markets. Monetary policy is felt to be appropriate but the panel is divided on the stance of fiscal policy. Stimulus from a modified version of the President's tax plan is expected later this year."

- A potential war in Iraq and domestic security concerns are the biggest threats facing the U.S. economy.
- Less than one-third of respondents feel increased regulation has instilled more confidence in our financial system.
- Current monetary policy is about right.
- A majority of panelists believe a modified version of the President's tax proposals will be adopted, with 59 percent expecting some dividend tax relief.
- Fiscal stimulus is expected to add 0.5 percent to real GDP growth in 2003.

Survey Highlights

War is the biggest problem facing the U.S. economy. Forty-one percent said international military operations and homeland defense were the biggest problems facing the economy. A growing federal deficit was identified as the next most pressing issue.

More corporate governance regulation is needed. Nearly half believe more regulation is needed, but less than one-third believe more regulation has boosted confidence in U.S. financial markets. Among the regulatory remedies suggested by panelists were creation of a separate sell-side research function in investment bank firms, cited by half the panel, and require expensing of stock options to employees, favored by 44 percent.

Monetary policy is about right. Eighty percent of NABE respondents feel monetary policy is about right; half expect short-term rates will be unchanged in six months and 37 percent expect rates will be between 25 and 50 basis points higher.

Views on fiscal policy are divided. Forty-two percent believe fiscal policy is about right. Those who think fiscal policy is too restrictive rose to 24 percent in this survey compared to only 15 percent who thought so last August. Although panelists think the odds for a double-dip recession are less than 50/50, nearly half now think fiscal, rather than monetary policy, should be used if one occurs.

Most expect a modified version of the President's tax relief proposals to become law. Nearly two-thirds of the respondents expect aid to states and municipalities will also be included in the budget. Fiscal stimulus is expected to add 0.5 percent to real GDP growth in 2003 and 0.65 percent to growth next year.

Survey Details

What NABE Panelists Are Worried About

By far, the single biggest risk facing the U.S. is war, according to our panelists. In stark contrast, six months ago only 3 percent said providing for homeland defense and preemptive operations abroad were problems. Not surprisingly, a growing federal deficit was the number two problem given the current environment of proposed tax cuts, reduced revenues and an unknown amount of outlays for a potential war in Iraq. Only six months ago, U.S. financial market instability and the danger of a stock market crash were the most worrisome topics.

Most serious problem facing the U.S. economy
(percent reporting)

	March 2002	August 2002	March 2003
International military operations/homeland defense	NA	3%	41%
Excessive growth in government spending/ growing federal deficit	11%	NA	11%
Overcapacity due to 10-year capital spending boom	9%	5%	8%
U.S. financial market instability/stock market crash	4%	44%	6%

Strengths in the U.S. Economy

Productivity gains and a technological lead are the greatest strengths of the U.S. economy. Survey responses to these two items have been consistent over the past year, with double-digit responses from each survey. Flexible labor markets earn third place, garnering around 10 percent of the responses. Last fall, deep capital markets garnered 24 percent of the responses but only 8 percent this time.

U.S. economy's greatest strength
(percent reporting)

	March 2002	August 2002	March 2003
Productivity gains	25%	25%	28%
Technological lead	29%	21%	26%
Flexible labor markets	9%	14%	10%
Deep capital markets	12%	24%	8%

Corporate Governance – More Regulation Needed

Nearly half of our panelists believe more corporate governance regulation is needed, while 31 percent think the rules on the books are adequate. Consistent with survey responses indicating that more work is necessary to increase trust in our financial system, only 29 percent believe that increased regulation has boosted confidence in the U.S. markets. Panelists are evenly divided between those who believe that more regulations would carry a greater price tag than benefits (44 percent) and those who believe the benefits would outweigh the costs (43 percent). Finally, a majority (55 percent) expects corporate behavior will become more risk averse as regulations concerning corporate governance increase.

We asked our panelists to tell us how pressing each of five remedies is; each proposed type of regulation received broad support from those who feel more regulation is necessary.

Rate the following five remedies
(percent of respondents ranking these remedies as very high and urgent)

Separate sell-side research function in investment bank firms	50%

Require expensing of stock options to employees	44%
More disclosure from hedge funds/investment managers	43%
Stricter guidelines for sell-side analyst stock recommendations	43%
Greater disclosure from mutual funds	40%

Current Monetary Policy Is about Right

Not since the Asian crisis in 1998 have panelists given the Fed such high marks for managing monetary policy. Eighty-one percent believe policy is about right, with equally small percentages of panelists feeling policy is either too restrictive or too stimulative. The Fed does not always get such high marks for its performance. If we look at the recent past, more than 20 percent felt monetary policy was too stimulative during the last legs of the bubble period, indicating a significant number of panelists felt the Fed was behind the curve. As the economy struggled to emerge from a recession, as many as one-third of our panelists felt monetary policy was too restrictive in March 2001.

Over the next six months, 63 percent would like to see policy remain unchanged, with a nearly even split between those who would like it to be more stimulative (19 percent) and those who would like monetary policy to be more restrictive (17 percent).

Current monetary policy is:
(percent reporting)

Date	Too restrictive	About right	Too stimulative
March 2003	8	81	9
August 2002	8	77	12
March 2002	3	78	17
August 2001	17	67	11
March 2001	34	56	7
August 2000	9	76	12
February 2000	5	62	32
August 1999	3	74	22
March 1999	2	75	23
October 1998	7	82	11
May 1998	2	76	22
February 1998	8	86	6
November 1997	4	83	7
August 1997	6	85	7
May 1997	12	74	14
February 1997	7	83	10
November 1996	14	77	8

Looking ahead, half of the panelists believe short-term rates will remain unchanged over the next six months. Compared to our August 2002 survey, a slightly greater percentage believes rates will increase over the next six months (37 percent) as did in August (31 percent). It may be worth noting, however, that the majority of this survey was completed before the March 7 employment report, which showed a 308,000 decline in jobs, was released.

Expectation for fed funds over next six months

Expectation	Percent responding
Unchanged	50
Increase by 50 basis points or less	18
Increase by 25 basis points or less	12
Decrease by 25 basis points s or less	7

Numbers may not add to 100 due to omitted and blank responses not reported.

Fiscal Policy Expected to Expand, Cutting Household Taxes Gets the Nod

In contrast to monetary policy, panelists were divided on the appropriateness of fiscal policy. A significant number, 42 percent, believe that fiscal policy is about right. One-third feel fiscal policy is too stimulative and one-quarter believes it is too restrictive. Panelists have shifted their views slightly over the past six months: now only 33 percent rather than 37 percent believe fiscal policy is too stimulative and 24 percent (up from 15 percent) believe fiscal policy is too restrictive.

The odds of a double-dip recession are less than 50/50, according to 60 percent of our panelists. Given this view of the economy, 33 percent of the panelists would like fiscal policy to be more stimulative over the next two years while 47 percent would like it to be more restrictive. That said, 70 percent believe fiscal policy will be more stimulative. We have seen a shift over the past six months, however, in that more panelists (49 percent vs. 26 percent in the August survey) think fiscal policy should be used if a double-dip recession occurs rather than monetary policy (34 percent of respondents).

When asked which type of fiscal policy tool to employ to offset a weak economy, 32 percent of our panelists prefer cutting taxes for households. More of our respondents (29 percent) favor additional tax cuts and incentives for businesses, up from only 19 percent who called for that type of stimulus in August. Finally, panelists are more wary of using government spending as a tool; only 20 percent called for greater government spending, down from 29 percent in August.

Tax Proposal – Bush Gets Something, the Economy Gets Something and No Significant Long-term Damage Expected

A majority of our panelists expect a modified version of the President's tax proposal will become law this year. Fifty-nine percent expect some type of reduction or elimination of the taxation of dividend income to individual shareholders and 53 percent expect a modified version of the accelerated tax cuts from the 2001 (including reduced marginal tax rates, a reduced marriage penalty, an increased child tax credit, and an expansion of the 10 percent income tax bracket) to pass. Additionally, 66 percent believe that aid to states will be part of a compromise package between the White House and Congress.

The boost to the economy from the stimulus package was estimated by our panelists to be 0.5 percent in 2003 and 0.65 percent in 2004. These were the median responses in terms of additions to real GDP growth rates. And 54 percent of the panelists believe that the package that is ultimately passed will boost long-term output slightly.

The survey revealed that NABE panelists believe the greatest effect of a larger deficit to be an increase in real long-term interest rates of 0.5% over the next five years, or 20 basis points annually. Respondents do not believe a structural deficit (one that implies full employment in the economy) that increases by 1% of GDP through the end of the decade will materially hurt private investment, long-term productivity growth or the dollar. Panelists expect the rate of inflation and financial returns in the stock markets to increase only marginally.

Estimate the impact over the next five years, if the structural federal budget deficit increases by 1 percent of GDP through the end of the decade:

	Median response (basis points)
U.S. real note yields, 10-year TIPS	50
Inflation, GDP chain price index	30
Personal savings rate	20
U.S. stock prices, S&P 500 total return	20
Private investment, share of GDP	0
Long-term productivity	0
U.S. dollar, FRB broad trade-weighted index	0

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