

Economic Policy Survey

NABE Panel: Majority Sees Current Monetary Policy as Appropriate, Is Split on Fiscal Policy

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*The NABE Economic Policy Survey presents the consensus of a panel of 242 members of the National Association for Business Economics. Conducted semiannually, this survey was taken July 30-August 10, 2010. 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. **Douglas Duncan**, Fannie Mae; **Michael Fratantoni**, Mortgage Bankers Association; **Richard Koss**, Fannie Mae; **Chad Moutray**, U.S. Small Business Administration; and **Emily Sanchez**, American Chemistry Council, conducted the analysis for this report.*

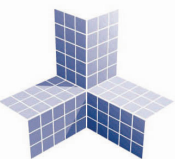
The August 2010 National Association for Business Economics (NABE) Policy Survey reveals that nearly sixty percent of respondents feel that monetary policy posture is appropriate at the present time* and that the greater risks facing the U.S. economy are deflation in the near term and inflation in the longer term.

*"The majority of the economists surveyed consider monetary policy to be currently appropriate, with greater disagreement over how the Federal Reserve should proceed over the next 12 months," according to NABE President **Lynn Reaser**, who is also chief economist for Point Loma Nazarene University. "Regarding fiscal policy, the economists generally believe the near-term focus should be the promotion of economic growth rather than deficit reduction. The majority of the respondents also do not believe another stimulus package is necessary but think the various tax cuts should be extended beyond their scheduled expiration at year-end."*

Thirty-nine percent of NABE Policy Survey panelists feel that the current posture of fiscal policy is appropriate, down from 44 percent in March. Three quarters of respondents oppose another stimulus package but rank promoting economic growth a higher priority than deficit reduction. Respondents support governmental action related to employment growth but rate clarity on future tax and regulatory policy as the top factor that would advantage employment.

About 60 percent of NABE members responding to the August survey agree that the federal assistance funds allocated to states through the American Reinvestment and Recovery Act (ARRA) were appropriate given the larger economic challenges at the time of the legislation's enactment; however, a similar share of panelists do not recommend that the federal government continue to "bail out" the states, even after the ARRA funds run out.

Survey respondents expect that the next year will be difficult for the "Club Med" countries, with most expecting that one or more of these countries will either be forced to restructure their debt or call on an outside funding source. Despite this expectation, about 80 percent of respondents expect that the Eurozone will remain fully intact.



Monetary Policy Currently Appropriate

A majority of the NABE Policy Survey panel thinks that Monetary Policy is currently positioned appropriately and do not believe the Federal Reserve will alter its pledge to “keep interest rates exceptionally low for an extended period” this year. Nearly 59 percent of respondents characterize current monetary policy as “about right,” with the remainder roughly evenly split between feeling it is too stimulative and too restrictive. Survey respondents are evenly split on the question of whether the Fed will start selling mortgage-backed securities out of its portfolio before the end of 2011, and a plurality feel the monetary policy risks are tilted toward deflation in the short run but toward inflation later on. Roughly half feel the Fed will start tightening too late and a similar share think the recently passed financial regulation bill will modestly reduce the risk of another global financial crisis.

Respondents were asked what monetary posture they **prefer** versus what they **expect** over the next 12 months. They were nearly evenly split among the three options, with “more restrictive” garnering 36 percent support, “more stimulative” 33 percent, and “unchanged” 31 percent. Only 37 percent of panelists expect short-term rates to rise in the next 12 months, with three-quarters of those seeing an increase of either 25 or 50 basis points.

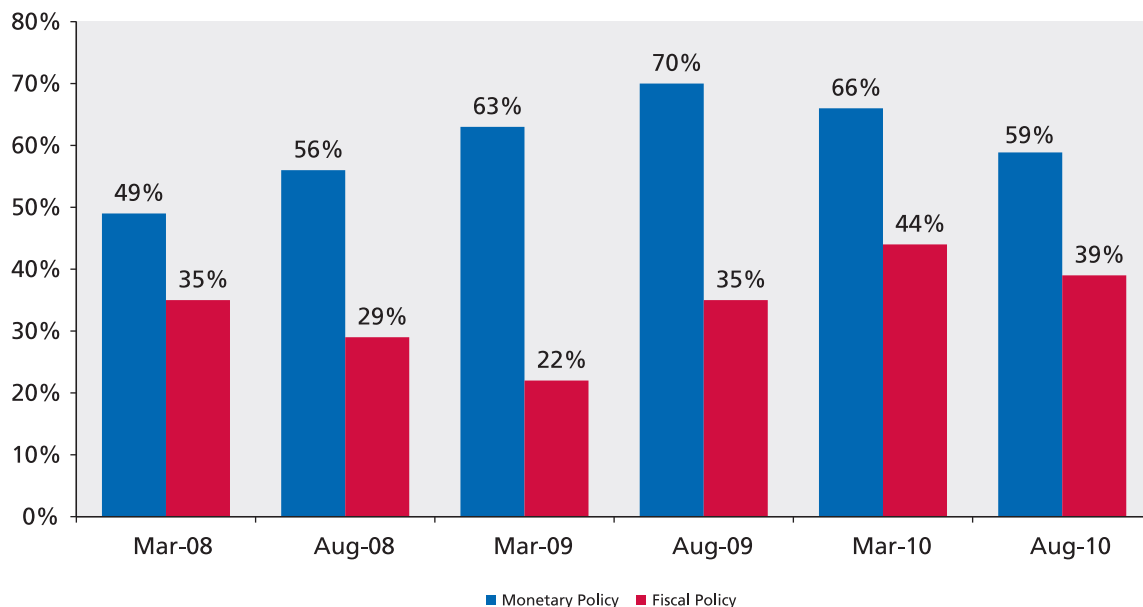
NABE members were asked about the risks of deflation versus inflation as outcomes of current monetary policy. A substantial minority of 45 percent feel deflation near term versus inflation longer term will be the highest risk outcome. Roughly equal shares of 15 and 16 percent see outright inflation or deflation as the bigger risks, with the remaining 24 percent feeling that neither risk dominates.

NABE members exhibit what might be termed a healthy skepticism regarding either the difficulty of the Fed’s challenge or the general ability of the Fed to achieve “good timing” in changing its policy stance. Just under 50 percent think the Fed will begin tightening policy too late while 36 percent think it will get the timing right. The remaining 14 percent believe the Fed will tighten too soon.

Panelists were asked whether they felt the Fed’s August 10th decision to reinvest proceeds from maturing mortgage-backed securities and bonds into Treasuries was appropriate. Seventy-seven percent support the decision.

Finally, survey respondents were asked to consider how the financial regulation bill, which was recently signed into law, would affect the potential occurrence of another global financial crisis. Nearly 89 percent feel it would have no or only a modest effect on reducing that risk, with 52 percent indicating that it would reduce those risks only modestly. Only 3 percent feel it would reduce the risk significantly.

Percent of NABE Panelists Who Consider Current Policy to be “About Right”



Fiscal Policy Confidence Declines

Thirty-nine percent of NABE members believe that the current posture of fiscal policy is “about right,” down from 44 percent in March, but still slightly above the 35 percent who held that view in August of 2009. Three quarters of respondents do not think another stimulus package is necessary to arrest the economic slowdown and return to growth. Nearly three quarters rank promoting economic growth a higher priority than deficit reduction and strong majorities suggest there should be a governmental focus on employment improvements or support. A majority of respondents do not believe that any of the individual income tax cuts, dividends tax cuts and capital gains tax cuts should be allowed to expire.

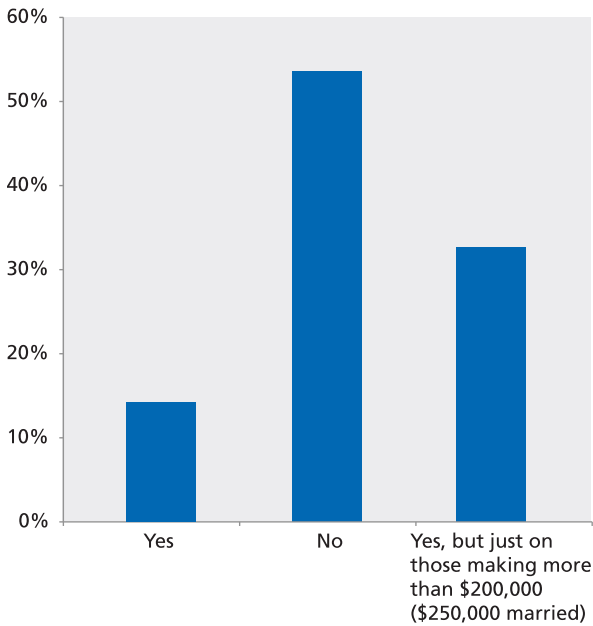
Nearly equal shares of respondents feel current fiscal policy is about right (39 percent) or too stimulative (37 percent) with the remaining 24 percent calling it too restrictive. Respondents were asked what fiscal policy posture they **prefer** versus what they **expect** over the next 24 months. A majority of 60 percent **prefer** a more restrictive policy and 48 percent **expect** that will be the case. Another 26 percent **prefer** a more stimulative policy and 23 percent **expect** it. The remaining 14 percent who prefer no change from current posture were accompanied by 30 percent who expect no change.

The last stimulus package contained both spending and tax incentives and while respondents are strongly against another such generic stimulus as necessary, they are opposed to the expiration of the tax cuts put in place in 2003, although with some nuances in their opinions. Fifty-four percent of respondents are opposed to the expiration of the individual tax cuts with another 33 percent opposed except for those that apply to higher-income households. Likewise, 62 percent oppose the expiration of the capital gains income tax cuts and another 22 percent oppose except for higher-income households. Finally, 60 percent oppose the expiration of the dividend income tax cuts with another 22 percent opposed except for higher-income households. Just under 50 percent suggested that the estate tax be reinstated but with a higher exemption level and lower tax rate. Another 33 percent said it should not be reinstated at all.

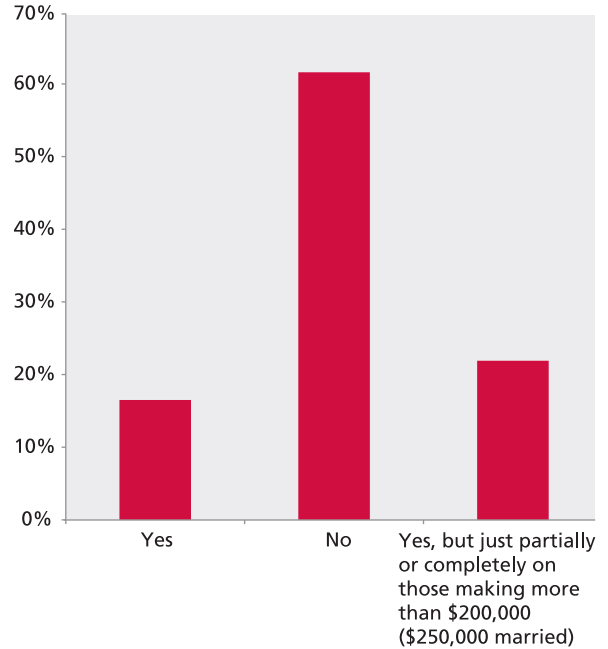
Given the longer-term importance of reducing the deficit, the survey respondents offered insights into the value of various tactics that have been suggested to reduce the federal deficit. Forty-two percent of respondents identify implementation of comprehensive tax and/or entitlement reform as the tactic that will have the greatest impact on deficit reduction. Another 20 percent expect that a combination of tax increases and expenditure reductions would have the greatest impact. A resounding 81 percent think the bipartisan National Commission on Fiscal Responsibility and Reform will be unable to produce a credible plan capable of garnering congressional support.

Finally, two thirds of the respondents support the extension of the unemployment benefits recently enacted by Congress and three quarters think the government should do more to support employment growth. However, respondents' top suggestion (supported by 41 percent) of the best way for the government to encourage increased employment was for government to give clarity on future regulation and tax policy. The second most popular answer, supported by 23 percent, was for government to give meaningful tax incentives for companies that increase hiring.

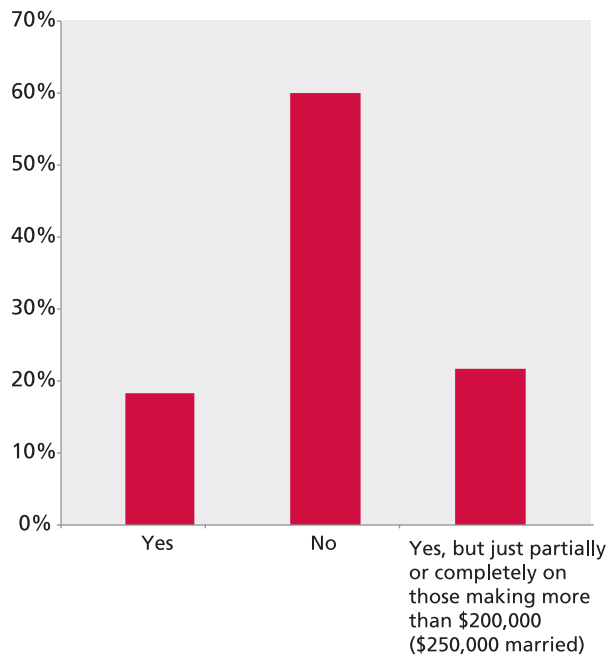
Should the individual income tax cuts be allowed to expire at the end of the year?



Should the capital gains tax cuts be allowed to expire at the end of the year?



Should the dividend income tax cuts be allowed to expire at the end of the year?



Should the estate tax be reinstated again after 2010?

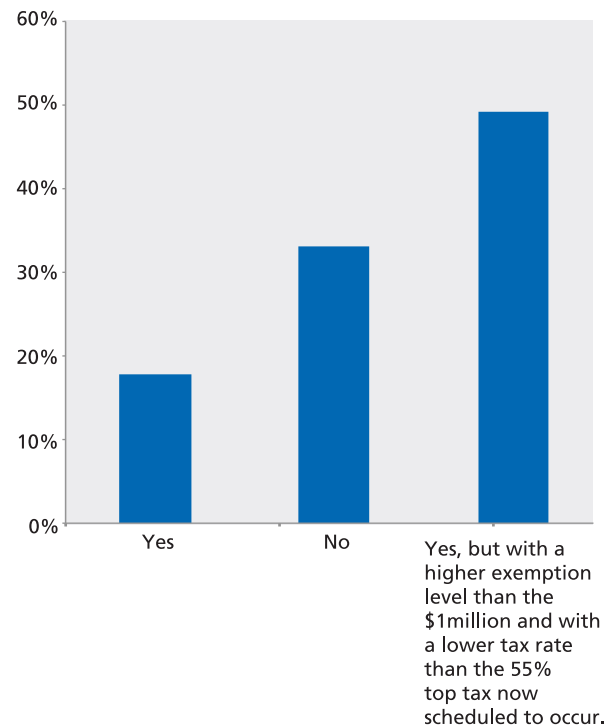


Table 1: Federal Deficit Reduction

Ordinal Rankings, with the lowest value being the most effective (ordinal rankings in parenthesis)

	Mean Score	% top choice	% top 3 choices
VAT	5.06 (6)	15.2% (1)	31.2% (3)
Flat tax	5.32 (8)	8.4% (6)	24.5% (6)
Mortgage interest/property tax deduction reform	5.22 (7)	8.4% (6)	27.0% (5)
Carbon Tax	4.74 (5)	6.3% (7)	30.8% (4)
Social Security Privatization	4.32 (4)	12.2% (2)	37.6% (1)
Reduced benefits/raising age limits for Social Security	4.22 (3)	9.7% (4)	31.2% (3)
Payroll tax increase	3.93 (1)	8.9% (5)	35.0% (2)
Medicare/Medicaid reform	4.03 (2)	11.4% (3)	23.6% (7)

State & Local Government Fiscal Challenges

State and local government tax revenues have fallen significantly during this economic recession, aggravating longer-term structural issues. According to the National Governors Association, 40 states made mid-year cuts totaling \$22 billion to their FY 2010 budgets, which followed \$31 billion in mid-year cuts in FY 2009. At the same time, 29 states adopted tax and fee increases in FY 2010 amounting to \$24 billion. Given the state and local budget shortfalls and weak employment growth, the fiscal situation is not expected to improve materially in FY 2011 or FY 2012. More budget cuts and tax increases are expected, especially in light of the fact that federal government stimulus money—which helped to alleviate even more drastic cuts in FY 2010—will be exhausted at the end of FY 2011.

With this in mind, survey participants were asked about federal assistance to the states. The federal government—which is not restricted by balanced budget requirements imposed at the state level—has more fiscal flexibility. As such, it has been argued that federal help to the states is essential, particularly by many economists in the Obama administration. Indeed, three in five respondents agree that the federal assistance funds allocated to states through the American Reinvestment and Recovery Act (ARRA) were appropriate given the larger economic challenges at the time; however, three in five also suggest that the federal government not continue to “bail out” the states, even after the ARRA funds run out.

Many of the challenges that states are facing are structural in nature. Economists who responded to this survey were asked to rank various remedies that might help correct these fiscal imbalances (Table 2). At the top of the list was the need to address benefits of public sector employees and state-level pension plans for public employees; nearly half of the survey respondents indicate that benefits needed to be cut for both current and future employees. Fifteen percent feel that benefit cuts should be limited to future employees, and 29 percent think that the pension solution should stem from the combination of increased tax revenues and reduced benefits.

Overall, respondents also believe that reducing the number of unfunded mandates from the federal government could work to correct fiscal imbalances in the future. In addition, NABE panelists indicate that state lawmakers should implement new programmatic cuts to state budgets and look to increase the size of their “rainy day” funds. Remedies expected to be less effective are attempting to increase revenue through tax changes and the consideration of constitutional changes or amendments that might enhance states’ flexibility in dealing with their fiscal challenges.

Despite the desire for more austerity, a large part of the solution to states’ current fiscal mess stems from the weak economy. NABE economists surveyed were asked to rank a list of options to boost growth (Table 3). The top-ranked remedy was to streamline and consolidate the regulatory process for businesses, followed closely by lowering the tax burdens on corporations. Over half of the respondents also listed either the granting of tax credits for hiring new employees or reforming unemployment compensation programs in their top three.

Table 2: State Budget Remedies to Correct Fiscal Imbalances

	% Replying "Yes" (might work)	Ordinal Rankings, with the lowest value being the most effective (ordinal rankings in parenthesis)		
		Mean	% Top Choice	% Top 3 Choices
Increasing the size of their "rainy day" funds	83.8%	3.68 (4)	12.1% (4)	40.5% (4)
Changing their constitutional requirements and amendments process to allow more flexibility	43.7%	4.17 (6)	9.9% (5)	31.0% (6)
Attempting to increase revenue through tax changes (e.g., higher corporate or personal income taxes, sales taxes, sin taxes)	40.4%	4.04 (5)	8.6% (6)	34.5% (5)
Reducing the burden related to benefits of public sector employees and the funding of state pension plans	86.8%	2.49 (1)	40.5% (1)	72.4% (1)
Reducing the number of unfunded mandates from the federal government	91.2%	2.95 (3)	18.1% (3)	63.8% (3)
Implementing new programmatic cuts to the state budget	89.7%	2.75 (2)	25.0% (2)	69.4% (2)

Table 3: Options for States to Promote Economic Growth

	Ordinal Rankings, with the lowest value being the most effective (ordinal rankings in parenthesis)		
	Mean	% Top Choice	% Top 3 Choices
Grant tax credits to new employees	3.04 (3)	18.1% (3)	55.2% (3)
Lower corporate tax rates	2.5 (2)	31.0% (2)	65.9% (2)
Delay implementation of environmental standards	3.69 (5)	6.0% (5)	34.5% (4)
Streamline and consolidate permit regulatory processes	2.25 (1)	32.8% (1)	78.4% (1)
Reform unemployment compensation programs	3.10 (4)	10.8% (4)	55.2% (3)

International

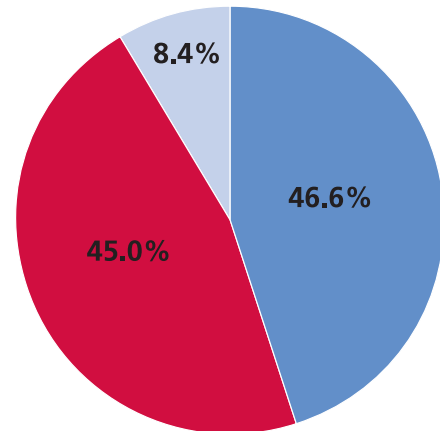
The first half of 2010 was plagued by fears of sovereign default. Global financial markets experienced increased volatility over the past six months as default fears shifted from financial institutions to sovereign governments, with Greece being the most prominent example. Several other countries, including Spain, Portugal, Ireland, and Italy have also faced increasing spreads on their debt, and the increased focus on government debt levels have led to tighter restrictions on government spending in the UK, and considerably more attention to the fiscal outlook for the US.

Survey respondents expect that the next 12 months will continue to be difficult for the “Club Med” countries. Over 90 percent of survey respondents anticipate that one or more of these countries will either be forced to restructure their debt or call on funding from the IMF or other Eurozone, with slightly more respondents expecting a debt restructuring. Despite this expectation, about 80 percent of respondents expect that the Eurozone will remain fully intact. Roughly 18 percent expect that one or more countries will leave the monetary union—either voluntarily or be forced to—but less than one percent of respondents expect that the euro will cease functioning as a common currency within the next 12 months. The majority of respondents agree that other Eurozone countries, the IMF, and the European Central Bank (ECB) played an appropriate role in providing funding to Greece through this crisis. The IMF received the highest marks, with almost 72 percent of respondents indicating that the international institution played an appropriate role. The ECB was also viewed favorably by nearly 69 percent of respondents.

Economists believe that austerity budgets can be successful, i.e., they can reduce deficits and debt fears without driving economies into recession. About 80 percent of respondents feel that austerity budgets will reduce deficits, while almost 70 percent believe that such budget discipline would be successful in calming sovereign debt fears. However, nearly 40 percent of respondents feel that such budget cuts would push economies into double-dip recessions. Only 11 percent fear that widespread austerity budgets would push the global economy into recession.

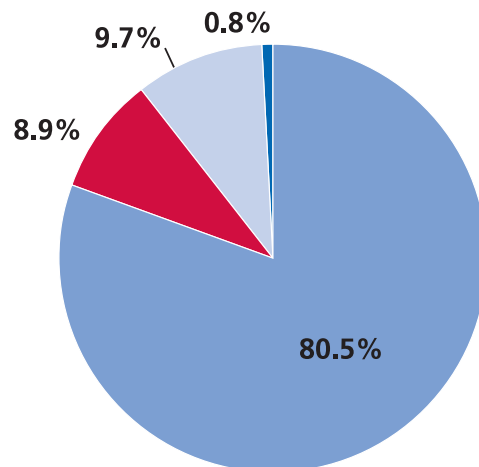
Economists participating in the survey generally feel positive about news that the Chinese government would allow the yuan to appreciate against the dollar. However, they were split on whether the appreciation would improve the US bilateral trade deficit with China. Still, about 70 percent of respondents think that the move would benefit the US economically, and 67 percent feel that it would benefit China, indicating that bringing the currency closer to market value is not a zero-sum game.

What will be the most likely outcome over the next 12 months with respect to these countries?



- One or more will be forced to restructure its debt
- One or more will call on funding from the IMF and other euro members, but will not be forced to restructure debt
- No European country will be forced to either restructure its debt or borrow from international financial institutions

What will be the most likely outcome over the next 12 months with respect to the Eurozone?



- The Eurozone will remain intact
- One or more countries will be forced to leave the monetary union
- One or more countries will voluntarily leave the monetary union
- The euro will cease functioning as a common currency

***Survey note:** Because most of the survey responses were submitted before the Federal Open Market Committee's (FOMC) August meeting, a special survey on key monetary policy issues was conducted on August 25th. This limited subset of monetary policy questions garnered roughly half the response rate of the original survey so interpretation of those results must be considered carefully. The larger sample of the earlier results showed 75 percent of respondents supporting current monetary policy as appropriate versus the 59 percent in the more recent smaller sample. The initial results also showed 53 percent expecting an interest rate hike in the next 12 months versus 37 percent in the latest survey. Although the change in the sample size might explain these shifts, the Fed's decision to reinvest maturing mortgage securities and bonds and recent further evidence of economic slowing were probably at least partly, if not primarily, responsible.

