Tea Leaf

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Your guide to understanding today's economy and financial markets

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A Roomful of Economists (yuk!)

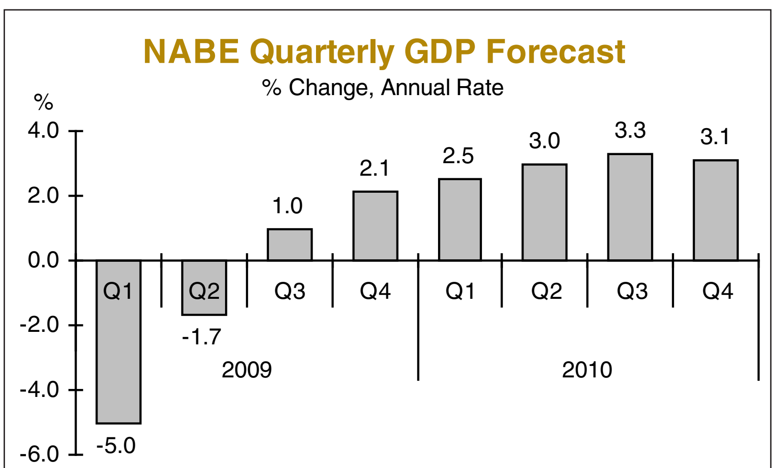
Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

The latest survey of 47 national economists (including yours truly) by the National Association for Business Economics was conducted in recent weeks and formally released on Monday, February 23. As one might expect, it was not pretty.

The consensus view has deteriorated sharply when compared to prior forecasts, which are conducted three times annually. *"The steady drumbeat of weak economic and financial market data have made business economists decidedly more pessimistic on the economic outlook for the next several quarters,"* noted Chris Varvares, the current president of the group. *"While a few reports offer some glimmer of hope, a meaningful recovery is not expected to take hold until next year."*

But Getting Better

As the chart notes, a sharp contraction in the U.S. economy is likely during the current quarter, with lesser pain during the spring. The consensus also sees soft, but at least positive growth (hurray!) returning during 2009's second half. Note: I still think it may be 2009's fourth quarter before growth returns, but what do I know…hey!…no rude comments!)



Source: National Association for Business Economics (NABE)

The forecast for calendar year 2009 is for a 0.9% real (after inflation) rate of contraction, when comparing this year's fourth quarter to last year's fourth quarter. This would be the most painful decline since 1982, and worse than the 0.2% decline by this measurement during 2008.

To show just how bad seasoned economists have been, last November's forecast consensus was for a 0.7% growth rate during 2009. Last May's forecast? A 2.7% growth pace during 2009…(nobody said forecasting the future is easy!)

These "crystal ball gazers" collectively now see the unemployment rate reaching 9.0% sometime in the fourth quarter, with the loss of another three million jobs in 2009, matching job losses during 2008. Overall corporate profits are expected to fall 9% this year, with housing starts and auto sales the weakest in decades.

Stock Market Optimism

The outlook for the stock market is very optimistic, with the consensus seeing the Standard & Poor's 500 at 975 by the end of the year, up 30% from the current level near 750. Note, however, that the consensus last November saw the S&P at 1200 at yearend 2009…ouch!

A Solid 2010

Better news involves the forecast for 2010. Prior optimism last November has been pushed back, not abandoned. The consensus sees 3.1% real growth in 2010. They see the unemployment rate beginning to fall, with the addition of 1.3 million jobs during the year. The consensus also expects housing starts and auto sales to at least reach the subdued levels seen during 2008.

Leading the Way

The United States is seen as the most likely major nation to emerge from recession first. Roughly one-third of the forecasters see the U.S. back on its feet first, followed by 28% who believe China will recover first. Another 13% see Canada first out of the recession litter box. Less than 4% expect Europe to lead the global recovery.

Fed View

The consensus view of 47 private sector national economists expressed on the prior page is roughly supported by the latest official forecast of the Federal Reserve. It is equally "dismal," a term used recently by Fed Chair Ben Bernanke.

The Fed's Forecast

Projections* by the Federal Reserve governors and bank presidents:

	2009	2010	2011
Change in real GDP	-1.3% to -0.5%	2.5% to 3.3%	3.8% to 5.0%
Unemployment rate	8.5% to 8.8%	8.0% to 8.3%	6.7% to 7.5%
Inflation	0.3% to 1.0%	1.0% to 1.5%	0.9% to 1.7%

*Central tendency; does not include three highest and three lowest forecasts.
Source: USA TODAY

The Fed's forecast for the American economy has also been downgraded sharply in recent months. While the Fed expects modest economic growth to return later this year, it won't be enough to offset decline during the first half.

"If we can take strong and aggressive action, including the Fed's actions to try to improve credit markets, I think we can break the back of this thing and that we will begin to see improvement in 2009," noted Bernanke in a speech on February 19. *"If we fail to take adequate actions, the situation would continue to deteriorate."*

The table above notes the official Fed forecasts (say that three times quickly). The number ranges exclude the three highest and three lowest forecasts of the 16 sitting monetary policy makers *(The Wall Street Journal)*.

Employment Pain

The unemployment rate is now expected to approach 8.8% later this year. While the forecast does see some decline in the jobless rate during 2010 and 2011, the rate is not expected to return to a more acceptable 5.0% level until 2012 at the earliest. By comparison, the U.S. unemployment rate, currently 7.6%, averaged 5.8% during 2008 and 4.6% during both 2006 and 2007.

The Fed's forecast for inflation suggests it will remain under control, with a longer-term outlook ranging from 1.5% to 2.0%. Many economists would agree with this view, although there is a wide disparity between those forecasters who expect to see sharply higher inflation pressures in coming years versus those who see the most likely scenario being a Japanese-style deflation after 2010.

Solid Growth

Like the view of private sector economists, the Fed has delayed its growth expectations, not dismissed them. The Fed's 2.5%-3.3% real growth expectation for 2010 would return the U.S. to more traditional growth norms.

The 3.8%-5.0% growth expectation for 2011 would be closer to economic boom conditions, likely driven by the impact of current massive fiscal policy pursuits (think Obama's $787 billion stimulus program) and the Fed's monetary stimulus, with the current 0.00%-0.25% federal funds rate the lowest ever. The issue of pent-up demand by millions of consumers also likely drives the Fed's optimistic growth projections, once we (finally) get through 2009…

…didn't we say that about 2008?

Jeff

Lowest Since 1955

As noted before, the sharp decline in U.S. inflation pressures—tied to the plunge in oil and other commodity prices of the past eight months—gives the Fed "cover" or support for its aggressive monetary actions. The Consumer Price Index (CPI) over the most recent 12-month period was unchanged, the best performance in 53 years.

The CPI rose 0.3% in January. The increase was the first monthly rise in six months. The rise was actually comforting to those who fear that deflation, or falling prices, will be the Fed's major challenge in coming years.

"TEA"sers

Anyone for a pun?

In democracy it's your vote that counts. In feudalism it's your count that votes.

Once you've seen one shopping center you've seen a mall.

A boiled egg in the morning is hard to beat.

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