United States Forecast Highlights

2010 Q2

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We remain bears in the United States economic forecast business. Our revised forecast has real GDP growth 150 basis points under the Wall Street Journal consensus in the third and fourth quarters of 2010. We are also softer than consensus in 2011 but more to the tune of 100 basis points. Why are we so dour?

United States Economic Growth Rates: CERF vs. Consensus

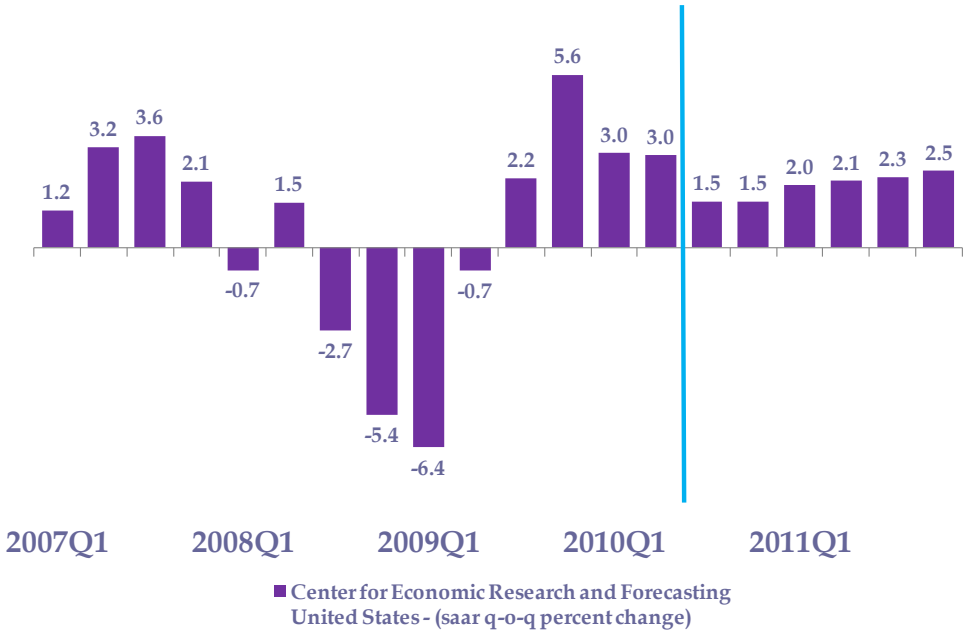
2010 Quarter 1 - 2011 quarter 4

2010		Qtr 1	Qtr 2	Qtr 3	Qtr 4
	CERF	3.0	3.0	1.5	1.5
	WSJ	3.0	3.6	3.0	3.0
2011		Qtr 1	Qtr 2	Qtr 3	Qtr 4
	CERF	2.0	2.1	2.3	2.5
	WSJ	2.9	3.0	n/a	n/a

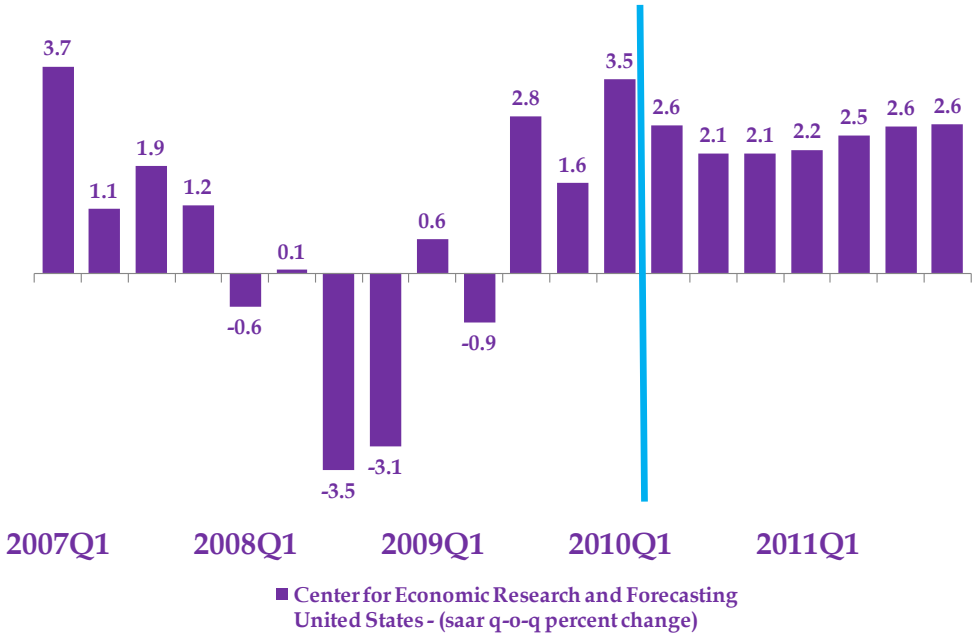
Units: seasonally-adjusted annualized growth rates
CERF: Center for Economic Research & Forecasting, CLU
WSJ: Wall Street Journal June 2010 Survey of 55 forecasters

Our GDP forecast is bottom up from the expenditure components. Our consumption forecast is likely to be weaker than consensus but I cannot confirm this as *GDP-component* consensus forecast breakdowns are not available. We forecast a reduction in real consumption growth in quarters 2 and 3, bottoming out at 2.1 percent in quarter 4. Our quarter 2 forecast of 2.6 percent could be high given the revised GDP data out today and the dismal May retail sales result.

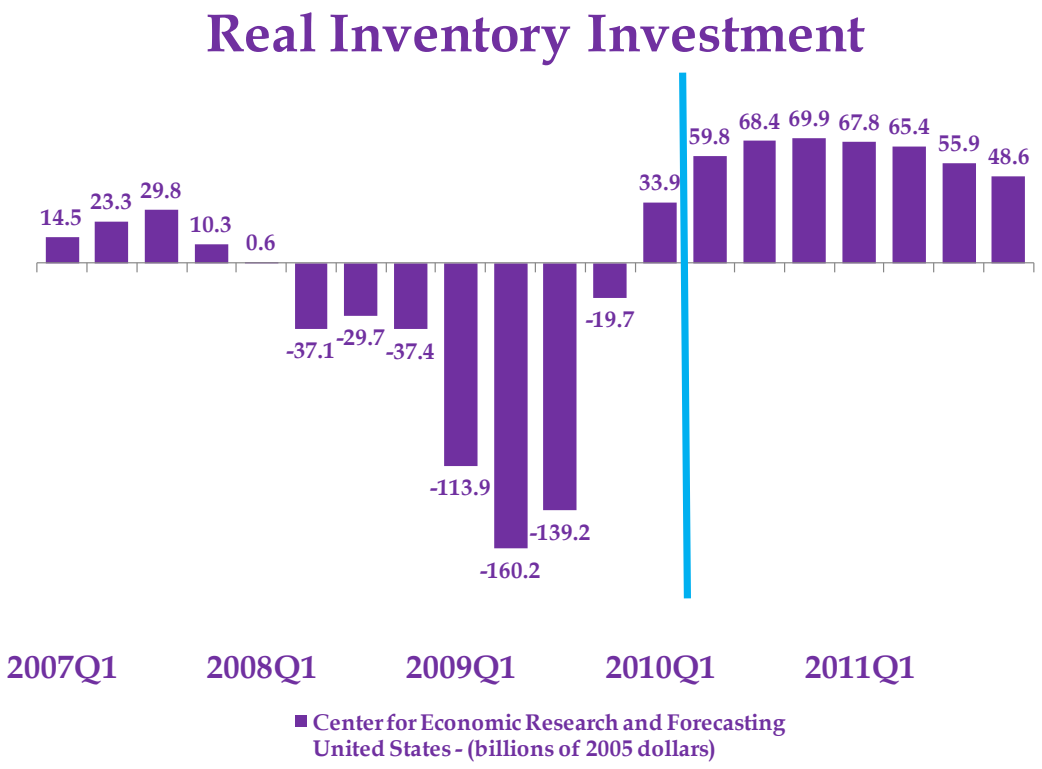
Real Gross Domestic Product



Real Consumption Growth

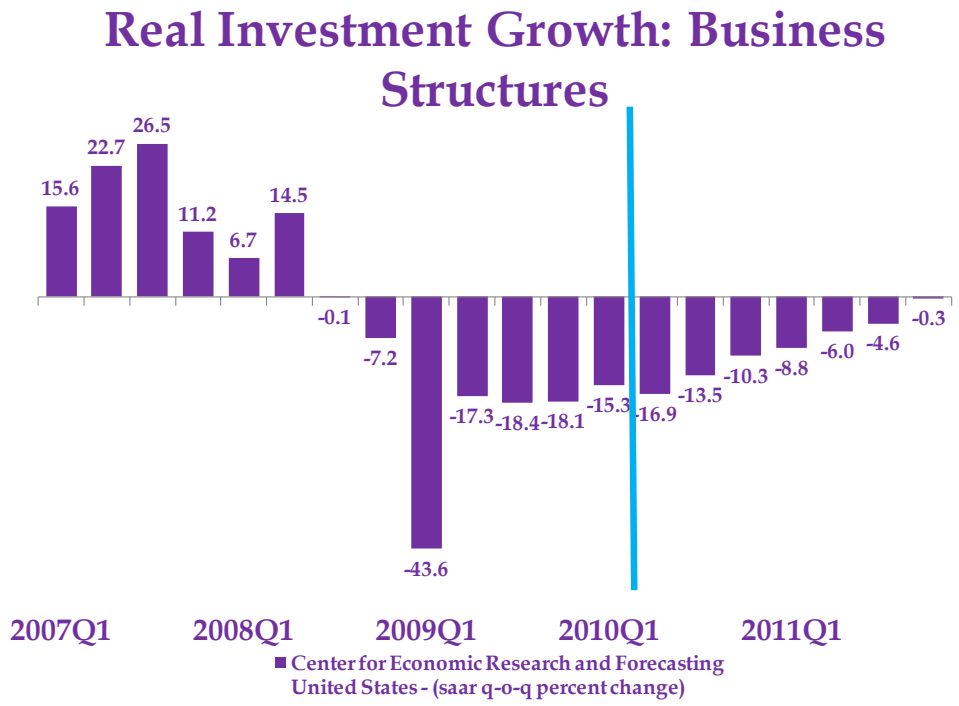


Our Investment expenditure forecast is built bottom-up from its components. We forecast inventory investment by looking at high frequency sales, inventories, orders, and inventory to sales ratios for retail and manufacturing. While inventories remain low, retail sales were quite weak in May. This weakness, especially if June and July retail sales are weak, could feed into less aggressive inventory level targets by the third quarter. The less aggressive inventory level targets would slow the growth of inventory investment flows that have been occurring since the third quarter of 2009. The improvement of $50 billion that occurred in 2010 quarter 1 would diminish to about $26 billion in 2010 quarter 2 and about $10 billion in 2010 quarter 3. Beginning in the first quarter of 2011, inventory investment will begin to fall.

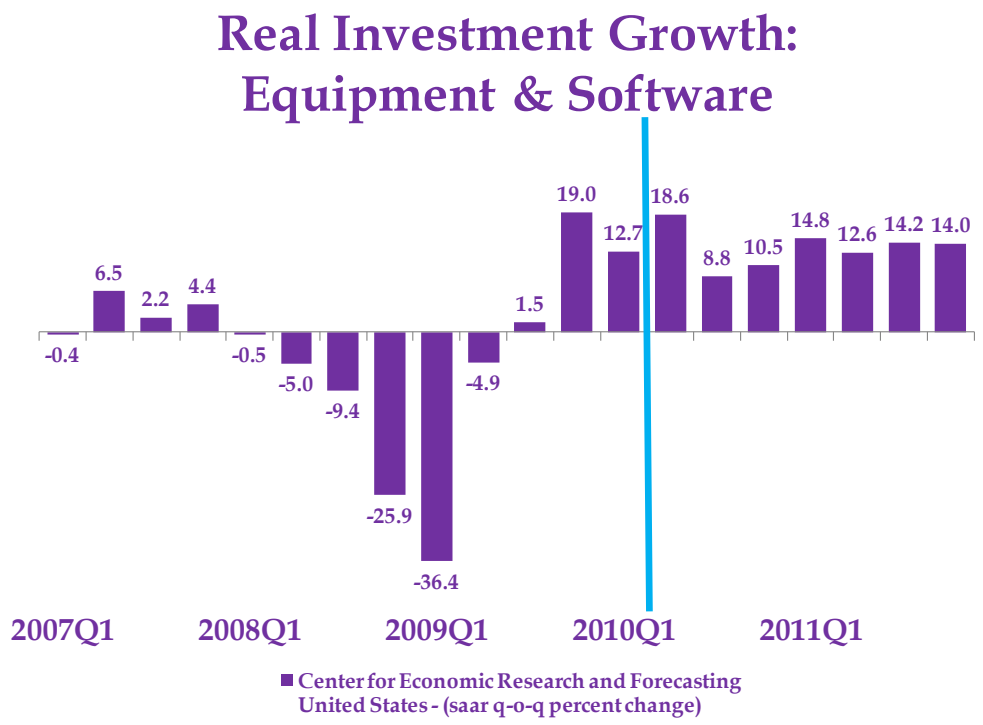


As Kirk explains in his real estate essay, we expect that commercial real estate will remain soft for some time, lagging other parts of the barely functioning United States economy. Non-residential structures investment experienced a double-digit negative growth rate in quarter one and our forecast maintains negative growth rates through the end of 2011.

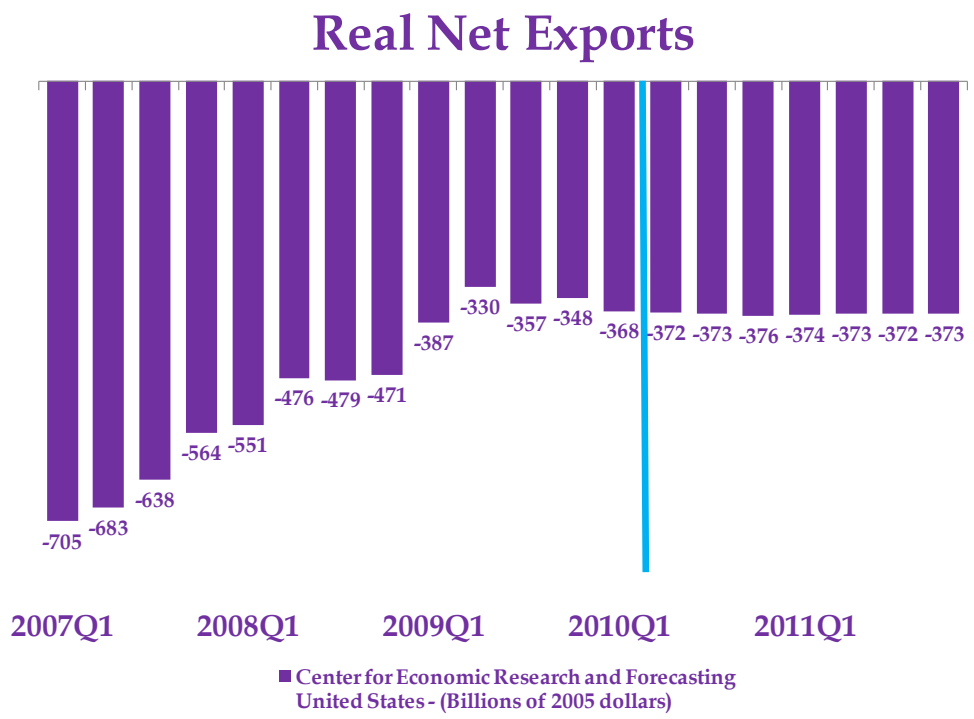
Residential real estate is probably not in much better shape than commercial, despite the fact that it declined much earlier than commercial. (Commercial real estate investment turned negative in 2008 quarter 2 while residential real estate investment turned negative in 2006 quarter 1.) Despite the fact that residential has been negative for 2 of the last 17 quarters, we believe that it cannot rebound with any strength due to a still large overhang of distressed sales and an over-supply of housing in certain markets.



Equipment and software investment has been strong for 2 quarters. We expect this strength to continue for the remainder of the forecast horizon. This is the strongest component of the expenditure decomposition of GDP. While this is good, it is not large enough by itself to imply rapid GDP growth.



Our trade forecast, imports and exports, essentially balance each other through 2011, leaving real net exports largely unchanged. Imports fell a bit in quarters 1 and 2 of 2010 for the same reasons that domestic consumption did, and exports subsided a bit during that time due to problems in Europe and its impact on trade.

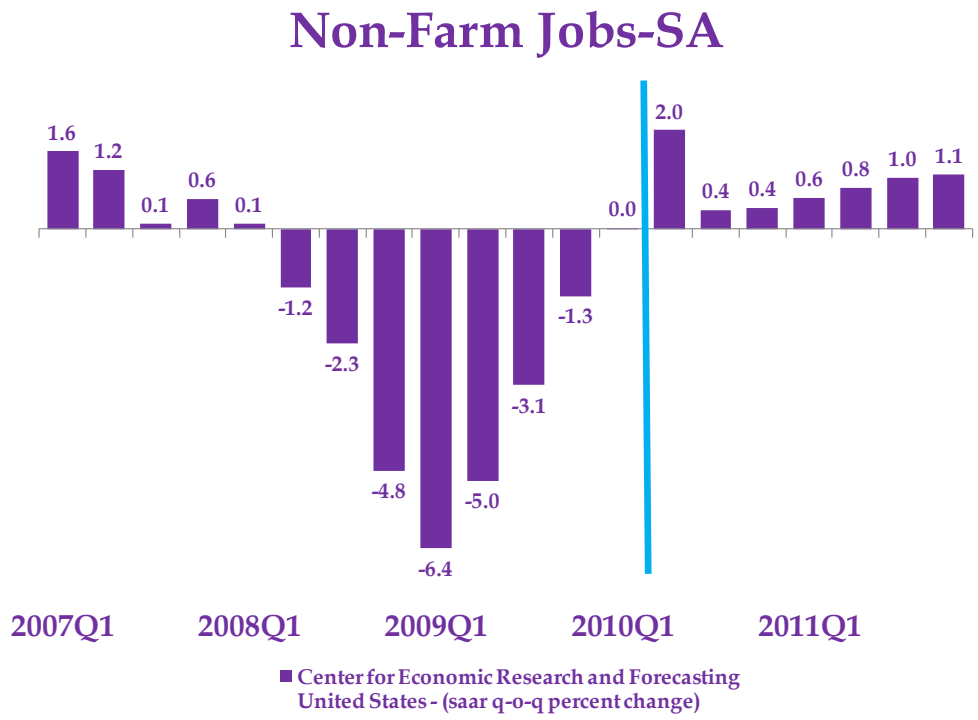


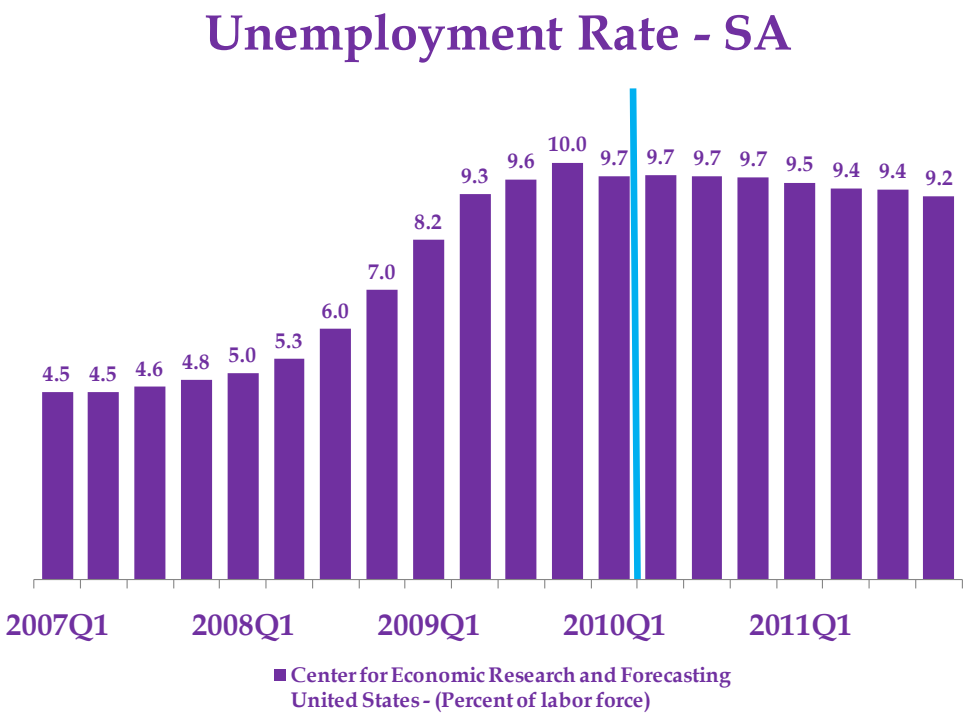
The final GDP component, Government expenditures, is not expected to grow during the forecast horizon. This is despite some expected growth in Federal expenditures. State and local government expenditures are sixty-percent of the Government portion of Gross Domestic Product. While Q1 2010 Federal government spending rose by an annualized inflation-adjusted rate of $3 billion, State and local government spending fell by $15 billion. We expect these kinds of State and local government spending declines to occur in each remaining quarter of 2010, and 2011 will not be much better.

From a sectoral view of the economy, there is growth in healthcare, international trade, and manufacturing; however these are not enough alone to generate overall GDP growth. Most of the other sectors in the United States remain too weak to generate growth. As well, the growth in international trade and manufacturing is low-job-generating growth due to technology and capital deepening. This jobless growth weakens overall growth because household sector wage and salary growth will remain low, keeping a lid on consumers' tendency to spend.

While there was a temporary pop in job growth due to Census hiring in April, May, and possibly June, this will disappear, weakening job growth. Job growth will not exceed one percent until the end of 2011. The weakness in the later half of 2010 and 2011 is due in part to expected state and local government job cuts as those entities deal with their constitutionally mandated balanced-budget requirements. As a result, the unemployment rate will remain high, still above 9 percent at the end of 2011.

Wealth growth is expected to remain weak through 2011 due mostly to weakness in real estate. Since wealth is an important driver of consumption expenditures and consumption is a large component of GDP, we expect relatively low economic growth. This brings us back to where we started, with slowing consumption growth.




Unemployment Rate - SA
4.5
4.5
4.6
4.8
5.0
5.3
6.0
7.0
8.2
9.3
9.6
10.0
9.7
9.7
9.7
9.7
9.5
9.4
9.4
9.2
2007Q1
2008Q1
2009Q1
2010Q1
2011Q1
Center for Economic Research and Forecasting
United States - (Percent of labor force)