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Economic Outlook Symposium: Summary of 2008 results and forecasts for 2009

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According to participants in the Chicago Fed's annual Economic Outlook Symposium, the nation's economic growth in 2009 is forecasted to be very weak, with inflation moving lower and the unemployment rate higher. The housing sector is predicted to remain weak, and light vehicle sales are expected to decline further.

The Federal Reserve Bank of Chicago held its twenty-second annual Economic Outlook Symposium on December 5, 2008. More than 90 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts from the previous Economic Outlook Symposium for 2008 and then analyzes the forecasts for 2009 (see figure 1) and summarizes the presentations from the most recent symposium.[1]

1. Median forecast of GDP and related items

	2007 (Actual)	2008 (Forecast)	2009 (Forecast)
Real gross domestic product[a]	2.3	0.2	0.7
Real personal consumption expenditures[a]	2.2	–0.9	0.7
Real business fixed investment[a]	6.4	–1.1	–3.9
Real residential investment[a]	–19.0	–19.2	–1.7
Change in private inventories[b]	–8.1	–26.6	15.0
Net exports of goods and services[b]	–484.5	–338.0	–315.5
Real government consumption expenditures and gross investment[a]	2.4	3.0	1.3
Industrial production[a]	2.2	–3.7	0.4
Car and light truck sales (millions of units)	16.1	13.3	12.7
Housing starts (millions of units)	1.34	0.94	0.87
Unemployment rate[c]	4.8	6.7	7.8
Consumer Price Index[a]	4.0	4.5	2.0
One-year Treasury rate (constant maturity)[c]	3.62	1.67	1.95
Ten-year Treasury rate (constant maturity)[c]	4.26	3.80	4.00
JPMorgan Trade-Weighted Dollar Index[a]	–7.1	–0.6	0.9
Oil price (dollars per barrel of West Texas Intermediate)[c]	90.85	67.77	71.70

[a]Percent change, fourth quarter over fourth quarter.
[b]Billions of chained (2000) dollars in the fourth quarter at a seasonally adjusted annual rate.
[c]Fourth quarter average.
NOTE: These values reflect forecasts made in November 2008.
SOURCES: Actual data from authors' calculations and Haver Analytics; median forecast from Economic Outlook Symposium participants.

The economy had to deal with several economic headwinds during 2008. The housing sector continued to be a substantial drag throughout the year, and credit conditions were ever tightening, Also, energy prices surged through the first half of the year. Despite these factors, the economy posted a 2.2% gain in the first half of 2008, compared with the first half of 2007. Activity fell slightly in the third quarter, with a decline of 0.5% (seasonally adjusted annual rate, or SAAR) from the second quarter.

The dramatic decline in lending activity that began in September 2008 brought an already elevated risk to the economic outlook to a tipping point. For example, borrowing costs from the risky high-yield corporate bond market rose from around 8% in the middle of 2007 to 11.5% at the end of August 2008. By the end of September, the interest rate rose to nearly 14%; then it moved up to nearly 19% by the end of October; and then it increased to more than 21% at the end of November. It took more than a year for this rate to rise 350 basis points by the end of August 2008, but the credit crisis in September caused the rate to increase an additional 1,000 basis points in just three months.

Prior to September 2008, it was a challenge to find parts of the real economy that were being materially affected by the turmoil in the financial markets. The dichotomy between the performance of Wall Street firms and Main Street firms was often mentioned. However, because of the crisis in September, nonfinancial firms and individuals began to experience reductions of available credit. As an illustration, the economy began shedding jobs in January 2008, but for the first eight months of the year, losses averaged 81,900 jobs per month. During the last four months of 2008, job losses averaged 483,500 jobs per month. With job losses, consumer spending began to retrench, falling 3.8% in the third quarter of 2008. For the first three quarters of 2008, light vehicle sales (car and light truck sales) averaged 14.1 million units (SAAR)—12.8% below the comparable year-earlier period. However, in the fourth quarter of 2008, sales fell to 10.3 million units (SAAR)—36.0% below the final quarter of 2007.

much all sectors of the economy. The unemployment rate was expected to rise to 5.0% in the final quarter of 2008; however, with GDP growth well below potential, the rate rose quite sharply to 6.9% (this as well as some of the other numbers cited in the text are based on data available after the 2008 symposium). Inflation, as measured by the Consumer Price Index (CPI), was predicted to average 2.6% during 2008, lower than the 4.5% rate now expected for the year. In part, the gap is explained by oil prices.

The 2008–09 period would mark the slowest two-year economic growth period since 1981–82.

It was not all bad economic news during 2008; international trade contributed quite a bit to the economy in 2008. While real gross domestic product (GDP) averaged 1.1% growth for the first three quarters of 2008, net exports contributed 1.6% to this growth. In other words, outside of trade, the economy would have recorded a 0.5% decline. In addition, oil prices, which peaked at $147 per barrel in July, fell to below $50 per barrel by the end of 2008.

Finally putting an end to a discussion that occurred quite often during the year, on December 1, 2008, the National Bureau of Economic Research's Business Cycle Dating Committee determined that economic activity had peaked in December 2007 and that the economy had begun a recession in January 2008.

Performance versus forecasts

At the 2007 Economic Outlook Symposium, participants had expected the economy to expand at a 2.5% rate in 2008. Using the consensus forecast for fourth quarter 2008 real GDP growth from the most recent Economic Outlook Symposium, real GDP is estimated to have risen by a very tepid 0.2% in 2008. (The remaining comparisons for GDP components use the consensus estimate from the most recent Economic Outlook Symposium for the fourth quarter of 2008 to calculate the annual values.) This overestimation of the economy's performance carried through to pretty

Oil prices were forecasted to average $86 per barrel for the year, and while oil prices closed the year quite low, they averaged $100 per barrel, 16% higher than predicted. Light vehicle sales were predicted to come in at 16.0 million units; this was clearly overly optimistic compared with the 13.1 million actually sold during 2008, the softest selling rate in 16 years. Housing starts were predicted to fall to 1.21 million units in 2008; however, housing starts actually decreased to 0.93 million units (SAAR) for the first 11 months of 2008. Similarly, residential investment was forecasted to decline by 4.0%, but it actually fell by a much greater 19.2%. One-year and ten-year Treasury rates were predicted to average 4.28% and 4.80%, respectively, by the end of 2008, versus actual rates of 0.99% and 3.25%, respectively.

Economic outlook for 2009

The forecast for 2009 is for economic growth to be quite weak. In 2009, the economy is expected to expand at 0.7%, following an estimated 0.2% increase in 2008. This would mark the slowest two-year economic growth period since 1981–82. With economic growth well below trend, the unemployment rate is expected to move significantly higher to average 7.8% in the fourth quarter of 2009. Since the economy will be experiencing tremendous slack in 2009, inflation, as measured by the CPI, is predicted to ease from 4.5% in 2008 to 2.0% in 2009. Oil prices are anticipated to rise somewhat, averaging almost $72 per barrel by the end of 2009. Personal consumption expenditures are forecasted to expand by a very slow rate of 0.7% in 2009. Light vehicle sales are expected to fall to 12.7 million, the lowest selling rate since 1991. Business fixed investment is expected to decrease 3.9%. Industrial production is forecasted to remain relatively flat, rising just 0.4% next year.

The housing sector is predicted to bottom out in the middle of 2009. Residential investment is predicted to fall by 1.7% in 2009, less of a drag than in 2008. The quarterly pattern of the forecast helps to identify when the consensus group expects the housing market to stabilize. After falling by a predicted 11.5% in the first quarter of 2009, residential investment is predicted to decline by a more moderate 5.0% in the second quarter and then remain unchanged in the third quarter. It is then expected to rise by 3.7% in the fourth quarter, which would mark the first positive gain in 15 quarters. Housing starts are anticipated to bottom out in the first half of 2009 at 0.81 million starts (SAAR) and then move up slightly to 0.88 million starts (SAAR) and 0.92 million starts (SAAR) in the final two quarters of 2009. For the year as a whole, 0.87 million housing starts are expected, the slowest pace of activity since the series began at the U.S. Department of Commerce in 1959.

The ten-year Treasury rate is forecasted to increase to 4.00% in 2009, and the one-year Treasury rate is expected to rise to 1.95%.

The trade-weighted U.S. dollar is predicted to edge higher in 2009, with an increase of 0.9%; and the trade deficit is predicted to decline further.

Financial outlook

James Bianco, of Bianco Research LLC, expected the financial markets to bottom out in the first half of 2009 and then slowly normalize throughout the remainder of the year, although he expressed slight reservations about this prediction. According to Bianco, the challenge to this forecast lies chiefly in the inability of the private financial sector to adequately support the needs of the broader economy. That is, at this juncture, the financial sector alone cannot provide enough cash flow and credit for the economy to operate as it had prior to the recession.

Bianco noted that the historic increase in national home prices has finally come to an end, after rising since 1939. He observed that, considering the U.S. residential real estate market is worth about $38 trillion, it comes as no surprise that the housing downturn has significantly impacted the rest of the economy. Moreover, government funding has largely replaced private sector funding (e.g., commercial paper[2]), partly because of the problems associated with mortgage-backed securities. Even the Federal Reserve, he noted, has stepped in and created new tools such as the Term Auction Facility[3] in an effort to stem extreme volatility across financial markets. Therefore, Bianco predicted that financial markets will slowly return to equilibrium in the second half of 2009 after home prices hit bottom.

Automotive outlook

William Shearin, formerly with Chrysler LLC, presented composite measures of consumers' "ability to buy" and "willingness to buy," based on various economic indicators for November 2008, compared with the same month the previous year. Both composite measures, Shearin explained, indicated that U.S. consumers were less likely to buy automobiles in November 2008 than in November 2007. To illustrate both measures, he used a traffic light analogy—green for positive, yellow for neutral, and red for negative.

For consumers' ability to buy, Shearin noted the following indicators: disposable income, household debt, yield curve,[4] and inflation. From November 2007 to November 2008, disposable income switched from green to red and inflation changed from yellow to red. However, some indicators were more favorable: Household debt switched from red to yellow, and the yield curve changed from yellow to green. Overall, according to Shearin, consumers' ability to buy switched from yellow to red over the 12-month period.

Shearin then discussed consumers' willingness to buy, based on the following indicators: consumer attitudes, unemployment claims, workweek (the average hours worked per week in manufacturing), and the stock market. Almost all of these indicators turned red in November 2008. The one exception was the workweek, which turned from green to yellow. Overall, consumers' willingness to buy moved from green in late 2007 to red in late 2008.

Clearly, the short-term outlook for the auto sector is not positive. However, Shearin expected that once the U.S. economy recovers—changing the "ability to buy" factors to green—consumers will buy new cars because the average age of used vehicles in the U.S. has been increasing in recent years and is now approximately 6.5 years (a historically high average). This bodes well for new automobile sales in the longer run.

Steel industry outlook

Robert DiCianni, ArcelorMittal, explained that during the first half of 2008, steel outperformed the overall economy because of some strong markets, including nonresidential construction, energy (pipeline construction), machinery, mining, farming, infrastructure, and exports. (Over the same period, the automotive market was the only major market for steel that was weak.) However, during the second half of 2008, all the markets for steel came to a screeching halt on account of the weakening economy.

DiCianni predicted that credit markets would unwind during the second quarter of 2009 and then business activity would return to normal over the next several quarters. He expected housing starts to bottom out in the second quarter of 2009. DiCianni anticipated that the fourth quarter of 2008 would be the worst quarter for steel consumption in this recessionary cycle. He forecasted raw steel production to fall to 19.7 million tons in the fourth quarter of 2008. Currently, steel shipments are down because liquidation of the steel is occurring very slowly. DiCianni noted that rolled steel inventories are not likely to be replenished in 2009 because total liquidation of existing inventories may continue well into 2009. Therefore, 2009 is anticipated to be a slow year for the steel industry. Nevertheless, domestic steel shipments are expected to gradually increase over the course of 2009, totaling 90.3 million tons.

DiCianni also commented on the cap-and-trade carbon emissions legislation, likely to be voted on by Congress in 2009. He stated that if the legislation imposes tough carbon emissions standards on U.S. manufacturers that are not matched in other countries, they will put domestic manufacturers, particularly those in the steel industry, at a significant competitive disadvantage, especially vis-à-vis developing markets. Moreover, if the cap-and-trade legislation passes in Congress, DiCianni argued, production will likely be transferred to less environmentally friendly production hubs, such as China. This would have a negative impact on domestic steel industry output.

Commodity prices and globalization outlook

Al Ambrose, CHS Inc., said he expected a good rest of 2008 and a strong 2009 for the farm and food sectors. At the time of the symposium, Ambrose predicted U.S. net farm income of $95.7 billion in 2008, up from the preliminary value of $86.8 billion in 2007. He forecasted yearly

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net farm income of over $100 billion for the next few years. Growth rates in food demand are still advancing—a trend driven in part by improved dietary intake in developing countries; and Ambrose said he hoped this trend would continue.

Ambrose forecasted a down year for world soybean production in 2007–08, but he expected production in 2008–09 to begin to edge up, especially considering the growing worldwide population. With the strong economic growth that Ambrose predicted for developing countries in the next few years, he argued that world food demand would be stimulated. For example, he anticipated Chinese vegetable oil imports to increase during 2009.

Heavy machinery outlook

Don Johnson, Caterpillar Inc., explained that the U.S. economy is in for a weaker year in 2009, and so is the market for heavy machinery, because of the distress in the housing and nonresidential construction industries. The mining industry—which buys a lot of construction machines—is expanding yet not outpacing the housing and nonresidential construction industries.

Johnson said that Caterpillar is forecasting overall 2009 sales for its construction equipment and related machines to stay at 2008 levels. This is partly due to the fact that heavy construction (e.g., for bridges) and general construction (residential and nonresidential) account for more than 50% of new machine distribution. As for heavy construction, Johnson said there will be a lag time between the official announcement of the Obama administration's spending plans on infrastructure and the placement of the orders for heavy machinery. With respect to general construction, Johnson expected both commercial and residential construction to be below historical levels in 2009. So, growth in these areas might not happen until after 2009.

There are some positive signs for the heavy machinery sector in 2009. In particular, weakness in demand for heavy machinery in North America, as well as in Europe, is expected to be offset by stronger demand among developing countries. Additionally, growth in the mining sector is expected to boost sales of equipment.

Conclusion

In 2008, the U.S. economy was challenged by the ongoing slowdown in housing, as well as surging energy prices throughout the first half of the year. It also experienced a dramatic decline in lending activity starting in September 2008; the credit crisis adversely affected not only Wall Street firms but also Main Street firms, resulting in job losses and decreases in consumer spending. With the continuing weakness in the housing market and uncertainty over credit market conditions, the nation's economic growth in 2009 is expected to be very weak, with inflation declining and the unemployment rate rising.

[1] Also see www.chicagofed.org/news_and_conferences/conferences_and_events/2008_eos.cfm.

[2] Commercial paper consists of short-term, promissory notes issued primarily by corporations. Many companies use commercial paper to raise cash needed for current transactions. See www.federalreserve.gov/releases/CP/about.htm.

[3] For details on the Term Auction Facility, see www.federalreserve.gov/monetarypolicy/taf.htm.

[4] A yield curve shows the relationship between yields and maturity dates for a set of similar bonds, usually Treasuries, at a given point in time.

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