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Economic Outlook Symposium: Summary of 2011 results and 2012 forecasts

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According to participants in the Chicago Fed's annual Economic Outlook Symposium, the U.S. economy is forecasted to grow at a pace below its historical average in 2012, following a year with an even slower rate of growth; inflation is expected to ease in 2012; and the unemployment rate is predicted to edge down this year.

The Federal Reserve Bank of Chicago held its twenty-fifth annual Economic Outlook Symposium (EOS) on December 2, 2011. More than 100 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts from the previous EOS for 2011, and then analyzes the forecasts for 2012 (see figure 1) and summarizes the presentations from the most recent EOS.[1]

1. Median forecast of GDP and related items

	2010 (Actual)	2011 (Forecast)	2012 (Forecast)
Real gross domestic product[a]	3.1	**1.6**	**2.0**
Real personal consumption expenditures[a]	3.0	**1.8**	**2.0**
Real business fixed investment[a]	11.1	**8.8**	**4.7**
Real residential investment[a]	–6.3	**1.6**	**3.4**
Change in private inventories[b]	38.3	**12.4**	**30.0**
Net exports of goods and services[b]	–414.2	**–409.4**	**–414.6**
Real government consumption expenditures and gross investment[a]	0.1	**–1.8**	**–0.9**
Industrial production[a]	6.3	**3.2**	**2.3**
Car and light truck sales (millions of units)	11.6	**12.6**	**13.4**
Housing starts (millions of units)	0.58	**0.60**	**0.66**
Unemployment rate[c]	9.6	**9.1**	**8.8**
Consumer Price Index[a]	1.2	**3.8**	**2.4**
One-year Treasury rate (constant maturity)[c]	0.26	**0.15**	**0.25**
Ten-year Treasury rate (constant maturity)[c]	2.86	**2.09**	**2.60**
J. P. Morgan Trade-Weighted Dollar Index[a]	–2.0	**–3.4**	**0.6**
Oil price (dollars per barrel of West Texas Intermediate)[c]	85.03	**88.88**	**92.00**

[a]Percent change, fourth quarter over fourth quarter.
[b]Billions of chained (2005) dollars in the fourth quarter at a seasonally adjusted annual rate.
[c]Fourth quarter average.
NOTE: These values reflect forecasts made in November 2011.
SOURCES: Actual data from authors' calculations and Haver Analytics; median forecast from Economic Outlook Symposium participants.

The U.S. economy continues to recover from the longest and deepest drop in economic activity since the Great Depression. The "Great Recession" lasted six quarters, beginning in the first quarter of 2008 and bottoming out in the second quarter of 2009. During the nine quarters following the end of the recession, the annualized rate of real gross domestic product (GDP) growth was 2.4%—roughly in line with what is considered the long-term historical rate of growth for the U.S. economy. But this GDP growth rate is very disappointing given that real GDP fell from its peak by more than 5% during the Great Recession. Generally, the pace of economic recovery is quite sharp following a deep recession. For example, consider what happened after the deep drops in economic output experienced during the mid-1970s and early 1980s; during the first nine quarters of positive output following these two recessionary periods, the annualized rate of real GDP growth was 5.0% and 6.3%, respectively (significantly higher than that of the current recovery). That said, unlike the deep recessions of the mid-1970s and early 1980s, the Great Recession was accompanied by a major financial crisis. Recoveries both in the U.S. and in other countries that follow recessions associated with financial crises tend to be rather restrained.

In the first half of 2011, real GDP growth slowed to an annualized rate of 0.8% from its average pace of 3.1% in 2010. This sluggishness was due in part to a surge in oil prices from Middle East unrest and disruptions in industrial production brought about by the earthquake in Japan. Since then, oil prices have moved substantially lower and industrial production appears to have recovered.

Employment losses that had begun in February 2008 continued to mount (even after the recession officially ended in June 2009) through February 2010.

Since then, the economy has been adding jobs, but the number of jobs added through December 2011 is just under 2.7 million—around 30% of the 8.7 million jobs lost. In addition to making up for these lost jobs, the U.S. economy needs to generate jobs to accommodate all the new entrants into the labor force. During the past decade, the labor force in the U.S. economy increased by an average of 1.3 million each year, according to the U.S. Bureau of Labor Statistics. Thus, a little over 5 million workers have been added since the start of the recession. All of these factors are reflected in the very high unemployment rate, which stood at 8.7% in the fourth quarter of 2011.

Given such slack in production, labor markets, and other parts of the economy, inflation has remained fairly low. As measured by the Consumer Price Index (CPI), inflation was 1.2% in 2010. However, following the unrest in the Middle East, oil prices rose more than 20%—to $110 per barrel in April 2011. Largely as a result of this jump in oil prices, inflation increased to an annualized rate of 4.7% during the first half of 2011. Since mid-2011, oil prices have pulled back, falling to $99 per barrel in December 2011. Core inflation, which removes more volatile food and energy prices, is more reflective than total inflation of the underlying slack in the U.S. economy. Core inflation remained low, with a year-over-year rate of 2.2% in November 2011.

The weakest sector of the economy remained housing. The annualized rate of housing starts stood at 0.60 million units through the first 11 months of 2011—well below the nearly 1.4 million annual housing starts that the U.S. averaged during the 1990s.

The industrial sector, whose level of output fell by more than 17% during the Great Recession, has been increasing its pace of production significantly since the end of the recession. From June 2009 through November 2011, industrial output grew at annualized rate of 5.4%, recovering about two-thirds of the loss experienced during the downturn. The two industries that fell by the largest percentage—automotive manufacturing and primary metals—are the two industries that have shown the strongest growth since the end of the recession through November 2011, with annualized growth rates of 25.5% and 18.2%, respectively.

In 2012, the growth rate of real GDP is expected to be 2.0%—below the long-term historical average.

Light vehicle sales (car and light truck sales) improved from 10.4 million in 2009 to 11.6 million in 2010—a nearly 12% gain. The annualized selling rate for light vehicles rose to 13 million units in the first quarter of 2011 from 12.3 million units in the previous quarter. However, the March 11, 2011, Japanese earthquake and tsunami and the subsequent nuclear disaster affected production facilities—especially those for automotive manufacturing—not only in Japan, but around the world. With supply shortages in manufacturing parts and increases in gasoline and vehicle prices, the annualized selling rate for light vehicles fell to 12.1 million units in the second quarter of 2011. Yet, with improving manufacturing supplies and lower gasoline prices since mid-2011, the annualized selling rate for light vehicles improved to 12.4 million units in the third quarter and 13.4 million units in the fourth quarter.

Performance versus forecasts

At the 2010 EOS, participants expected the economy's real GDP growth rate to be 3.0% in 2011. According to the consensus forecast from the most recent EOS, the growth rate of real GDP in the fourth quarter of 2011 relative to the fourth quarter of 2010 is estimated to be 1.6%—nearly half the rate predicted previously. (The remaining comparisons for GDP components use the consensus estimate from the most recent EOS for the fourth quarter of 2011 to calculate the annual values.) Real personal consumption expenditures were also weaker than forecasted, but real business fixed investment came in a bit stronger than expected. Real residential investment experienced some improvement, but not as strong as anticipated. The unemployment rate was expected to decline to 9.2% in the final quarter of 2011; at 8.7%, the actual fourth quarter rate recorded was much better. Inflation, as measured by the CPI, was predicted to average 1.6% during 2011—much lower than the 3.8% rate now expected for the year. This gap can largely be explained by oil prices, which were forecasted to average $84.83 per barrel during 2011, below the $95.08 that oil prices actually averaged for the year. Light vehicle sales were predicted to come in at 12.7 million units in 2011—exactly matching the 12.7 million actually sold during the past year. Housing starts were predicted to rise to 0.69 million units in 2011; however, housing starts showed little improvement, with the annualized rate of starts edging up to 0.60 million units for the first 11 months of 2011. Similarly, real residential investment was forecasted to rise strongly, at rate of 9.6%, but it is expected to have increased more modestly, at a pace of 1.6%. One-year and ten-year Treasury rates were predicted to rise to 0.62% and 3.07%, respectively, by the end of 2011; however, they actually declined to 0.11% and 2.05%, respectively.

Economic outlook for 2012

The forecast for 2012 is for the pace of economic growth to be below the historical average. In 2012, the growth rate of real GDP is expected to be 2.0%—an improvement from the projected 1.6% rate for 2011. The quarterly pattern reveals a slightly stronger second half of the year compared with the first half. The forecasted growth rate of real GDP rises from an annualized rate of 1.9% in the first half of 2012 to 2.1% in the second half of the year. With the economic growth rate predicted to be below its long-term historical average, the unemployment rate is expected to remain quite high, edging down to 8.8% in the final quarter of 2012. Inflation, as measured by the CPI, is predicted to fall from an estimated 3.8% in 2011 to 2.4% in 2012. Oil prices are anticipated to rise somewhat, averaging around $92 per barrel in the final quarter of 2012. Real personal consumption expenditures

are forecasted in 2012 to expand, at a rate of 2.0%. Light vehicle sales are expected to rise to 13.4 million units this year. Real business fixed investment is expected to record a solid growth rate of 4.7% in 2012. Industrial production is forecasted to see its growth slow to a rate of 2.3% this year.

The long-struggling housing sector is predicted to improve further in 2012. Real residential investment is forecasted to increase in 2012, at a rate of 3.4%—which would be its best performance since 2005. Housing starts are also anticipated to improve—from a predicted 0.60 million starts in 2011 to 0.66 million starts in 2012. While better than the previous year, the anticipated 2012 level for housing starts would be less than half of the 20-year annual average of 1.43 million starts.

The one-year Treasury rate is expected to rise to 0.25% in 2012, and the ten-year Treasury rate is forecasted to increase to 2.60%. The trade-weighted U.S. dollar is predicted to edge higher in 2012; and the trade deficit (net exports of goods and services) is predicted to remain relatively unchanged.

Automotive outlook

Ellen Hughes-Cromwick, Ford Motor Company, noted that the Japan disaster and Thailand floods that occurred last year significantly reduced the supply of automotive parts. Starting in the second quarter, production in the U.S. fell drastically, leaving automakers with suboptimal inventories of vehicles. Despite the shortages, U.S. auto sales still improved gradually throughout 2011. Inventories are expected to be rebuilt in the coming quarters—in line with an anticipated stronger automotive selling rate. In addition, the average age of vehicles in the U.S. is now at record highs (above ten years), so strong pent-up demand for new vehicles should boost future sales, Hughes-Cromwick argued. She also noted that interest rates for auto loans have been quite low lately, supporting further auto sales; but credit conditions remain tight for those with poor credit histories.

Hughes-Cromwick also presented an optimistic outlook on global automotive sales. Many emerging markets are reaching a phase in their economic development characterized by an acceleration in consumer purchases of vehicles. Countries such as China, India, Mexico, and South Africa have reached per capita income levels where vehicle sales growth accelerates well beyond GDP growth. Finally, Hughes-Cromwick explained that much more room for auto sales growth still exists in such emerging markets. For example, for every 1,000 drivers, China and India had only 58 and 25 vehicles on the road in 2009, respectively, whereas the U.S. had 1,005 vehicles.

Steel outlook

Robert DiCianni, ArcelorMittal USA, observed that the Great Recession disproportionately affected steel-intensive manufacturing sectors, such as motor vehicles, primary metals, and machinery. However, during the recovery, such sectors have rebounded strongly, helping the steel industry to outperform the overall economy. DiCianni said he expected most steel-intensive markets to continue growing, albeit moderately, with the auto, energy, machinery, and mining sectors leading the way. However, he predicted nonresidential construction—the largest market for steel—to remain weak during the coming year. Accordingly, DiCianni forecasted U.S. steel consumption to reach 103.2 million tons in 2012, up from 65.1 million tons in 2009, but still well below the annual consumption levels before the recession.

While U.S. steel consumption is still below its pre-recessionary levels, world steel consumption is anticipated to reach a record high of almost 1.4 billion metric tons in 2011 and is expected to reach almost 1.5 billion metric tons in 2012. Thus, DiCianni said he expected raw materials for steel to remain in tight supply in 2012. The demand for steel in emerging markets has been very sharp over the past few years; e.g., China alone consumed 46% of all steel in 2011. Hence, emerging markets should continue to drive up the global demand for steel in the coming years, DiCianni noted.

Heavy machinery outlook

Frank Manfredi, of Manfredi and Associates, gave a robust outlook on the heavy machinery industry because many sectors that depend on heavy machinery are expected to continue to perform very well. Elevated prices for agricultural commodities and record highs for farm real estate values (up 15% from three years ago) have left farmers flush with cash. According to Manfredi, total sales of farm tractors are expected to be up 6.1% in 2012, following a year with around 10% growth. The sales outlook for construction and mining machinery is more mixed but still strong, Manfredi said. Residential and nonresidential construction continues to be quite weak, with publicly funded projects up slightly. However, more machinery will be necessary to mine large shale deposits, which have increasingly become an important source of natural gas. In addition, mineral commodity prices (e.g., those for coal and copper) have stabilized at high levels, boding well for heavy machinery sales.

Manfredi observed that the demand for heavy machinery in developing countries should continue to be strong. Agricultural and food production, construction, and mining activities are expanding in emerging economies, so developing countries are expected to account for a growing share of heavy machinery sales

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over time. Before the Great Recession, the U.S. consumed over half of the construction machines made in the world; China has since claimed that distinction.

Financial and consumer outlook

John Silvia, Wells Fargo, explained that the household debt service ratio—the ratio of debt payments to disposable personal income—has returned to more sustainable levels in the past two years. Many households have successfully reduced their debt, and consumer confidence and personal consumption have also improved recently. However, such positive trends have been observed chiefly among high-income households, whose net worth is not as dependent on a home's value as it is for low- and middle-income households. Since the recession, financial assets like stocks have rebounded, but home values have largely remained depressed. Silvia said he did not see these trends changing in the near term.

Housing starts are expected to remain subdued in 2012, noted Silvia. Mortgage payment delinquencies and housing inventories have come down in recent quarters from their all time peaks, but still remain elevated. Additionally, falling prices for existing homes have softened the already weak demand for new homes. Over the period 1997–2006, the price for a new home was, on average, only $19,000 more than the price for an existing home. Since then, the average difference has risen dramatically, reaching $60,000 in late 2011.

With respect to business lending, Silvia said U.S. banks are lending more and lowering their credit standards to encourage even further borrowing. However, the demand for loans has fallen sharply in recent months; many companies already have the cash to fund their own expenditures. Silvia said he expected U.S. banks to continue facing challenges in 2012. On a positive note, he pointed out that although the European sovereign debt crisis still looms, U.S. banks have relatively little exposure to the troubled debt issued by European countries such as Italy and Greece.

Small business outlook

William Dunkelberg, National Federation of Independent Business (NFIB), explained that small businesses play a vital role in the U.S. economy—e.g., they employ over half of all private sector employees and account for roughly two-thirds of all new jobs each year. Since the recession, however, small businesses have been forced to reduce their employment drastically as consumers cut back on spending. Labor costs account for 80% of small businesses' total costs, so once sales and earnings plummeted, employment quickly followed. Small businesses have also been reluctant to build up their inventories or expand their operations. The primary problem, Dunkelberg said, is weak consumer demand. Consumer sentiment is at its lowest point since the recessionary period of the early 1980s, Dunkelberg explained, and according to the NFIB's Small Business Optimism Index, small business owners do not expect this to turn around anytime soon. The slow pace of the economic recovery is not likely to change soon, he said.

Conclusion

In 2011, the U.S. economy expanded at a slow pace. This sluggish growth rate was due in part to temporary factors such as a spike in oil prices caused by Middle East unrest and industrial production disruptions brought about by the earthquake in Japan. The economy in 2012 is forecasted to grow at a slightly faster rate than it did in 2011, but the pace will still be below its long-term historical average. The housing sector is predicted to continue to improve in 2012, as are light vehicle sales. The unemployment rate is expected to edge lower by the end of 2012, but remain extremely high by historical standards; and inflation is predicted to moderate.

[1] Also see www.chicagofed.org/webpages/events/2011/economic_outlook_symposium/index.cfm.