Chartwell Consulting

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Richard D. Shaffer, CFA
Director of Research

What Economists are Forecasting for the Second Half of 2005

Each January and July, about 50 economists and assorted pundits participate in the Wall Street Journal's semi-annual economic forecasting survey. The July 2005 survey hit the papers earlier this month. Alongside current forecasts were those made on January 2, 2005. These folks are some of the country's most influential financial thinkers, so we keep track of 'em.

Short-term Interest Rates – The least surprising economic development in this year's first six months was the path of the Fed Funds rate. Wall Street "knew" it would be 3.0% on June 30th, and then rise to 3.25% during the following week (it did). Thus, the Treasury bill rate forecast was almost exactly correct. Turning the December '05 T-bill forecast around, we can surmise the consensus is expecting two more 25bps increases in the Fed Funds rate this year.

Long-term Interest Rates – January's consensus was for the 10-year Treasury bond's yield-to-maturity to rise in close tandem with the rising Fed Fund's rate. Didn't happen. Didn't come close to happening. Long-term bond yields *declined* by almost 30bps in the first half of 2005, versus the consensus forecast for a 55bps rise. Said differently, the 10-year T-bond's price at the end of June was nearly 7% more than had been expected just six months earlier. Bloodied, but unbowed, the group again forecasts a rise in the 10-year yield over the next six months, to 4.60%.

Real GDP Growth – Despite the 1st quarter's moderate upside surprise (+3.8% growth versus +3.5% forecast), economists are continuing to ratchet down their median forecasts in this area, and seem generally less willing to depart from the pack. Compared to original estimates, annualized growth rate forecasts have been knocked back by 0.2% for each of the next four quarters, and are rather tightly bunched around the +3.4% figure. That seems like a good number: since the short recession in 2001, the percent growth in GDP from the prior quarter has averaged +3.4% (annualized). But, the range has been +0.7% to +7.4%. Expect surprises in this area.

Consumer Price Inflation – Forecast in January to be only 2.5% on a trailing year/year basis, the actual May '05 figure was instead a bit higher, at 2.8%. However, that compared favorably to last November's 3.5% year/year figure, as overall price gains moderated during the first half of 2005 compared with the last half of 2004. Inflation just accelerated in the areas of energy and housing, which get all the press coverage. The current forecast through November is for the same rate of change in the CPI, +2.8%.

Value of U.S. Dollar – Having completely missed the Dollar's weakness during last year's 2nd half, the January consensus completely missed the Dollar's strength during this year's first half. Predicted to decline 1% versus the Yen, it instead rose 7.5%. And, the Dollar has gained 11% against the Euro so far this year, compared to a predicted +2%. Looking forward, consensus expectations are for the Euro to end 2005 unchanged from June 30th, at 1.21$/€, while the Yen is anticipated to rise almost 5%, to 106¥/$.

Unemployment Rate – The actual May '05 figure was lower than had been forecast, at 5.1% versus 5.3%. And, it dropped still lower in June. But, employment growth this year has been much lower than previously expected. What gives? It's all in the way they calculate the rate. Current expectation is for no change in the year-end unemployment rate from current levels, as slowing GDP growth causes further slowing in employment growth.

Our Take on This? - The consensus still foresees the same type of smooth sailing, "steady as she goes" economic environment we've had for the past 3+ years (14 consecutive quarters of GDP growth). It's just that increasing headwinds, largely in the form of moderately rising interest rates, are expected to slow the boat down a bit. We're very concerned about the collective impact of our enormous trade and fiscal deficits, almost nonexistent domestic savings rate, and high level of consumer financial leverage, but these things don't seem to be keeping the economists up at night.

Consensus Economic Forecasts for Second Half 2005

-- First Half 2005 Forecasts -- *(as of January 3, 2005)*

	3 month T-Bills @ JUNE '05	10 year T-Bonds @ JUNE '05	GDP 1st Qtr 2005	GDP 2nd Qtr 2005	GDP 3rd Qtr 2005	GDP 4th Qtr 2005	CPI Yr/Yr Chg. @ MAY '05	¥en / $ Spot rate @ JUN '05	$ / Euro Spot rate @ JUN '05	Unempl. Rate @ MAY '05
Survey Average	3.04%	4.79%	+3.5% *(was 3.7%)*	+3.6% *(was 3.7%)*	+3.6%	3.6%	2.5%	102 ¥/$	1.33 $/€	5.3%
Survey Range *	2.40 – 3.40	4.25 – 5.50	2.2 – 4.5	2.5 – 4.6	2.8 – 4.6	2.7 – 4.7	1.9 – 3.3	95 - 115	1.20 – 1.45	4.9 – 5.6
ACTUAL 6/30/05 ***(actual 12/31/04)***	**3.13%** ***(2.21%)***	**3.94%** ***(4.22%)***	**+3.8%**	**???**	**???**	**???**	**2.8%** ***(3.5%)***	**111 ¥/$** ***(103 ¥/$)***	**1.21 $/€** ***(1.36 $/€)***	**5.1%** **(5.4%)**

-- Second Half 2006 Forecasts -- *(Posted on July 1, 2005)*

	3 month T-Bills @ DEC '05	10 year T-Bonds @ DEC '05	GDP 3rd Qtr 2005	GDP 4th Qtr 2005	GDP 1st Qtr 2006	GDP 2nd Qtr 2006	CPI Yr/Yr Chg. @ NOV '05	¥en / $ Spot rate @ DEC '05	$ / Euro Spot rate @ DEC '05	Unempl. Rate @ NOV '05
Survey Average	3.81%	4.60%	+3.5% *(was 3.6%)*	+3.4% *(was 3.6%)*	+3.3%	+3.3%	2.8%	106 ¥/$	1.21 $/€	5.1%
Survey Range *	3.25 – 4.30	3.95 – 5.20	2.7 – 4.2	2.5 – 4.2	2.5 – 3.9	2.5 – 4.1	2.4 – 3.6	100 - 115	1.10 – 1.34	4.7 – 5.4
ACTUAL 12/31/05 ***(actual 6/30/05)***	**???** *(3.13%)*	**???** *(3.94%)*	**???**	**???**	**???**	**???**	**???** *(2.8%)*	**???** ***(111 ¥/$)***	**???** ***(1.21** *$/€)*	**???** *(5.1%)*

* Excluding outliers

Sources:

"The Wall Street Journal Forecasting Survey for 2005 and 2006", 7/1/2005
"The Wall Street Journal Forecasting Survey for 2005", 1/3/2005