



## *An Economic Forecast for the First Half of 2004*

Each January and July, about 50 economists and assorted pundits participate in the Wall Street Journal's semi-annual economic forecasting survey. The first survey for 2004 hit the papers earlier this month. Alongside current forecasts were those made by survey participants in early July 2003, for the year-end timeframe. Both surveys are summarized in the attached tables.

Some of the previous survey's guesses can be pretty embarrassing, as you might imagine. Like one economist's forecast of a 1.6% annualized *decline* in third quarter GDP (it grew at a +8.2% rate, which was the fastest for any quarter in the last 20 years), or someone's projection of a 0.85 \$/€ foreign exchange rate (actual at the end of December was 1.26). Can you imagine the fallout if his firm (sorry, it was a guy) listened to him, and hedged to that rate!

Consensus predictions from the midyear survey proved wide of the mark on interest rates (actual market yields were much lower than forecasted), GDP growth (way too low for the 3<sup>rd</sup> quarter), and the Dollar/Yen and Dollar/Euro exchange rates (actuals were much weaker than forecast). Consensus forecasts of November '03 inflation and unemployment rates proved to be very close to the actual levels.

Which brings us to the current survey. Check out the interest rate guesses. There is not a single economist out of 54 who thinks the 3 month T-bill rate will be at its current level come the end of June. Everyone expects it will be higher, although the 2.5% guess was an outlier (next highest was 2.0%). Turning to long-term rates, only two economists forecast the 10-year Treasury bond to remain at or below its '03 year-end yield (it is currently at 4.10%). Everyone thinks interest rates are going to start rising well before the Presidential election.

That's because they think GDP growth will continue to be quite robust. Although the WSJ spared everyone the opportunity to get the 4<sup>th</sup> quarter GDP wrong, other surveys indicate a 4.5% consensus number. Thereafter, the WSJ group forecasts continued 4+% annual rates for each of the first three quarters in 2004. Interestingly (okay, maybe not), the group foresees the year-over-year change in CPI to be just 1.9% for May (gets reported in June), despite strong GDP growth. That's no real change from today, although two folks see the CPI change hitting 2.6% by May, which probably requires an assumption that oil prices reach the \$45-50 range (gulp!).

The collective guess is that the unemployment rate will be 5.7% for May '04, which was exactly the figure for last month. Not what you'd call a stretch guess, even if the projected November '04 unemployment rate is down to 5.4%. Finally, the consensus sees the Dollar effectively stabilizing for the first half of 2004, but the range of estimates is very wide indeed, at  $\pm 10\%$  from current levels.

Our take on all this? Inflation is quite low and expected to remain so, interest rates are very low and expected to rise only moderately. Accordingly, *real* interest rates are low and stable (which is a very good situation for borrowers). Job growth is expected to be positive, but low enough that it will likely be described as weak. Nevertheless, the GDP growth rate is projected to be consistently above average, implying that our economy will be increasingly driven forward by continued robust increases in business investment spending and government deficit spending – but more so by the former than the latter. The term “sweet spot” comes to mind for the time being, unless our massive trade and budget deficits tank the Dollar and accelerate the rise in real interest rates.



**-- Second Half 2003 Forecasts --** (Posted on July 3, 2003)

|  | 3 month<br>T-Bills<br>@ DEC '03 | 10 year<br>T-Bonds<br>@ DEC '03 | GDP<br>3 <sup>rd</sup> Qtr<br>2003 | GDP<br>4 <sup>th</sup> Qtr<br>2003 | GDP<br>1 <sup>st</sup> Qtr<br>2004 | GDP<br>2 <sup>nd</sup> Qtr<br>2004 | CPI<br>Yr/Yr<br>Chg.<br>@ NOV<br>'03 | Yen / \$<br>Spot rate<br>@ DEC '03 | \$ / Euro<br>Spot rate<br>@ DEC '03 | Unempl.<br>Rate<br>@ NOV '03 |
|--|---------------------------------|---------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|--------------------------------------|------------------------------------|-------------------------------------|------------------------------|
| Survey<br>Average                        | 1.01%                           | 3.85%                           | +3.5%<br><i>(was 3.7%)</i>         | +3.8%<br><i>(was 3.7%)</i>         | +3.8%<br><i>(was 3.6%)</i>         | 3.7%                               | 1.9%                                 | 119 ¥/\$                           | 1.14 \$/€                           | 6.1%                         |
| Survey Range                             | 0.70 - 1.80                     | 2.75 - 4.60                     | (1.6) - 5.4                        | (2.0) - 6.8                        | 1.8 - 5.5                          | 2.1 - 5.5                          | 1.0 - 2.6                            | 110 - 130                          | 0.85 -<br>1.25                      | 5.5 - 7.7                    |
| <b>ACTUAL</b><br><i>(as of 12/31/03)</i> | <b>0.91%</b>                    | <b>4.25%</b>                    | <b>+8.2%</b>                       | <b>??</b>                          | <b>??</b>                          | <b>??</b>                          | <b>1.8%</b>                          | <b>107 ¥/\$</b>                    | <b>1.26 \$/€</b>                    | <b>5.9%</b>                  |

**-- First Half 2004 Forecasts --** (as of January 9, 2004)

|   | 3 month<br>T-Bills<br>@ JUN '04 | 10 year<br>T-Bonds<br>@ JUN '03 | GDP<br>1 <sup>st</sup> Qtr<br>2004 | GDP<br>2 <sup>nd</sup> Qtr<br>2004 | GDP<br>3 <sup>rd</sup> Qtr<br>2004 | CPI<br>Yr/Yr Chg.<br>@ MAY '04 | Yen / \$<br>Spot rate<br>@ JUN '04 | \$ / Euro<br>Spot rate<br>@ JUN '03 | Unempl.<br>Rate<br>@ MAY '04 |
|---|---------------------------------|---------------------------------|------------------------------------|------------------------------------|------------------------------------|--------------------------------|------------------------------------|-------------------------------------|------------------------------|
| Survey<br>Average                       | 1.32%                           | 4.75%                           | 4.5%<br><i>(was 3.8%)</i>          | 4.3%<br><i>(was 3.7%)</i>          | 4.1%                               | 1.9%                           | 106 ¥/\$                           | 1.23 \$/€                           | 5.7%                         |
| Survey Range                            | 0.95 - 2.50                     | 4.00 - 5.50                     | 2.7 - 6.3                          | 3.0 - 6.3                          | 3.0 - 5.7                          | 1.2 - 2.6                      | 95 - 117                           | 0.98 - 1.34                         | 5.4 - 6.2                    |
| <b>ACTUAL</b><br><i>(as of 6/30/04)</i> | <b>???</b>                      | <b>???</b>                      | <b>???</b>                         | <b>???</b>                         | <b>???</b>                         | <b>???</b>                     | <b>???</b>                         | <b>???</b>                          | Nov '04 = 5.5%               |

**Sources:**

"The Wall Street Journal Forecasting Survey for 2003 and 2004", 7/3/2003

