

I. ECONOMIC FORECAST

July 2009

This edition of the National Economic Review and Forecast contains excerpts from Nigel Gault, *U.S. Economy: Current Situation: Forecast Flash*, Global Insight, July 2009. This publication summarizes Global Insight's baseline national forecast that OEA incorporates into the Oregon economic and revenue models. Editorial comments written by OEA staff are enclosed in []. In addition, Table N.1 provides a quick look at the annual rates. Table N.2 provides a look at the forecast change from the last forecast. Graph N.1 provides a graphic U.S. history and forecast. A full version of Global Insight's U.S. Executive Summary can be found at our website.

<http://www.das.state.or.us/DAS/OEA/docs/economic/nationalfull.pdf>.

A. National Economic Review and Forecast

Forecast Flash

The Road to Recovery

The road to recovery will be a long one, but the first steps are being taken. We expect the rate of contraction in GDP to have slowed in the second quarter to minus 2.1%, from minus 5.5% in the first quarter. Absent the continuing, severe inventory adjustment, growth would be only just below zero. In the second half of the year, the inventory cycle will begin to turn and we expect to see GDP moving higher. But a rapid recovery is not in prospect, after so extreme a financial shock. The unemployment rate is not likely to peak until some time in the first half of 2010, at around 10.3%.

Transition to Growth. As is characteristic of a turning point in the economy, the incoming indicators are a mixed bag, and it is getting harder for them to beat expectations. Up to now, indicators have mostly pointed to an economy contracting, but less sharply than before. As we move into the second half of the year, indicators should increasingly point to growth. The latest manufacturing ISM report for June shows both orders and production indicators at around the breakeven 50 mark. It also shows a very severe contraction in inventories. This combination is setting the stage for an upturn in manufacturing production during the third quarter, as some industries (notably automobiles) will need to increase production to prevent inventories from running down too far.

Consumer Spending Has Flattened Out. Consumer spending essentially moved sideways in the second quarter, edging down an estimated 0.3% from the first quarter. Reduced tax withholding and one-time payments to Social Security recipients have boosted incomes, but that has gone into saving rather than spending. And rising gasoline prices have squeezed spending power. Given reduced household wealth, debt overhangs, and still-tight credit, it is hard to make a case for a robust consumer recovery, but we do expect spending to gradually improve over the rest of the year as the labor market deterioration becomes progressively less severe.

Housing Is Bottoming Out. Most key indicators of housing activity (home sales, housing starts and permits) are showing signs of stabilization, at least for single-family units, based upon dramatically improved affordability—for those who can qualify for credit. Even though there will be a delay after housing starts hit bottom until residential construction spending starts to rise, the latter should occur by year-end.

Business Equipment Spending to Turn by Year-End. We expect second-quarter business equipment spending to drop 12.2%, about one-third the rate of decline seen in the first quarter. The bellwether demand indicator—nondefense capital equipment orders excluding aircraft—appears to have stabilized. We expect equipment spending to begin its recovery in the second half of the year.

Business Construction Spending Has a Long Way to Fall. Nonresidential construction spending, in contrast to equipment spending, probably rose in the second quarter. But the gains are narrowly based in oil refining and power generation, and are unsustainable. The trend for commercial construction such as retail developments, offices, and hotels remains downwards. Business construction spending has much further to fall.

Foreign Trade Will Become a Drag. The United States is likely to lead rather than lag the global recovery, and we therefore expect imports to move up earlier and more sharply than exports. Foreign trade has cushioned the U.S. downturn, but in a similar fashion we expect it to act as a brake on the recovery, at least in its initial phases, as imports revive.

Inflation Threat Not Immediate. We think that some commodity prices—notably oil—have moved up in advance of the fundamentals, and see some correction as likely. But even without such a correction, we see too much excess capacity in product markets and, especially, in the labor market for an inflation spiral to take hold any time soon. Inflation is a real long-term threat, and will require "exit strategies" from both monetary and fiscal stimuli. But there is sufficient time available to plan a way out. We do not expect the Federal Reserve to begin to raise interest rates until the second half of 2010.

—Excerpted from Nigel Gault, *U.S. Economy: Current Situation: Forecast Flash*, Global Insight, July 2009

Figure N.1*

	Quarterly				Annual				
	1Q 09	2Q 09	3Q 09	4Q 09	2008	2009	2010	2011	2012
Real GDP (Percent change)	-5.5	-2.1	0.6	1.1	1.1	-2.8	1.5	3.1	3.8
Federal Funds Rate (Percent)	0.18	0.18	0.13	0.13	1.93	0.16	0.24	1.70	3.34
Ten-Year Treasury Yield (Percent)	2.74	3.32	3.57	3.65	3.67	3.32	3.72	3.91	4.50
Oil Prices, WTI (Dollars/barrel)	43	60	59	60	100	55	64	73	79
Consumer Price Index (Percent change)	-0.2	-1.0	-2.0	0.6	3.8	-0.6	1.8	2.4	2.2
Housing Starts (Millions)	0.53	0.51	0.57	0.62	0.90	0.56	0.87	1.29	1.56
Consumer Sentiment (Univ. of Michigan)	58	68	67	68	64	65	72	73	76
Unemployment Rate (Percent)	8.1	9.3	9.8	10.1	5.8	9.3	10.2	9.7	8.8

* Figure N.1 was taken from Nigel Gault, *U.S. Economy: Current Situation: Forecast Flash*, Global Insight, July 2009.

TABLE N. 1
U.S. Forecast Summary 2007-2016 (Jul 2009 U.S. Forecast, Global Insight)

	Quarterly			Annual											
	2009:2	2009:3	2009:4	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016		
GDP (Bil of 2000 \$) Chain Weight	11,299	11,317	11,347	11,524	11,652	11,331	11,500	11,860	12,305	12,666	13,000	13,360	13,742		
% Ch	(2.1)	0.6	1.1	2.0	1.1	(2.8)	1.5	3.1	3.8	2.9	2.6	2.8	2.9		
Personal Income (Bil of \$)	12,165	12,086	12,132	11,663.3	12,100.7	12,108.1	12,375.1	12,873.0	13,553.3	14,277.5	15,038.9	15,828.2	16,653.3		
% Ch	3.9	(2.6)	1.5	6.1	3.8	0.1	2.2	4.0	5.3	5.3	5.3	5.2	5.2		
Nonagricultural Employment (Millions)	132.2	131.4	131.0	137.6	137.0	132.1	131.4	133.5	136.7	139.5	141.4	142.9	144.5		
% Ch	(4.4)	(2.2)	(1.3)	1.1	(0.4)	(3.6)	(0.5)	1.6	2.4	2.0	1.4	1.1	1.1		
Unemployment Rate	9.3	9.8	10.1	4.6	5.8	9.3	10.2	9.7	8.8	8.1	7.7	7.4	7.0		
% Ch	76.7	22.1	11.8	0.4	25.4	60.1	9.9	(5.0)	(9.9)	(7.6)	(4.4)	(4.2)	(5.5)		
Industrial Production Index (2002=100)	96.2	97.2	97.8	111.3	108.8	97.6	99.1	103.2	108.5	112.6	115.8	119.2	122.7		
% Ch	(11.2)	4.5	2.6	1.5	(2.2)	(10.3)	1.6	4.1	5.2	3.7	2.9	2.9	3.0		
Corporate Profits (Bil of \$)	1,346.9	1,470.9	1,490.6	1,886.3	1,597.3	1,415.0	1,607.8	1,881.5	1,954.7	1,972.7	1,940.6	1,976.0	2,026.2		
% Ch	(1.4)	42.2	5.5	0.7	(15.3)	(11.4)	13.6	17.0	3.9	0.9	(1.6)	1.8	2.5		
Money Supply (M2) (Bil of \$)	8,318	8,416	8,520	7,382	7,992	8,520	8,967	9,503	9,980	10,422	10,858	11,363	11,943		
% Ch	3.0	4.8	5.1	5.8	8.3	6.6	5.2	6.0	5.0	4.4	4.2	4.6	5.1		
Prime Rate	3.25	3.25	3.25	8.05	5.09	3.25	3.33	4.70	6.34	6.55	7.59	7.75	7.75		
% Ch	0.0	0.0	0.0	1.2	(36.8)	(36.1)	2.5	41.0	35.1	3.3	15.9	2.1	0.0		
Consumer Price Index (1982-84=100)	213.2	214.3	215.2	207.3	215.2	213.8	217.6	222.9	227.8	232.7	237.6	242.8	248.0		
% Ch	1.2	1.9	1.7	2.9	3.8	(0.6)	1.8	2.4	2.2	2.2	2.1	2.2	2.2		
Federal Budget (unified) (Bil of \$, Fed FY)	(333.8)	(474.8)	(393.9)	(187.9)	(680.5)	(1,651.4)	(1,156.9)	(853.3)	(717.2)	(569.6)	(626.5)	(687.7)	(710.8)		
Current Account Balance (Bil of \$)	(418.1)	(504.9)	(583.1)	(726.6)	(706.1)	(478.0)	(639.1)	(685.3)	(742.5)	(733.3)	(718.2)	(700.3)	(690.0)		
% Ch	12.47	112.77	77.87	(9.6)	(2.8)	(32.3)	33.7	7.2	8.4	(1.2)	(2.1)	(2.5)	(1.5)		
Population (Millions)	307.98	308.73	309.49	302.41	305.37	308.36	311.37	314.38	317.41	320.48	323.58	326.70	329.84		
% Ch	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0		

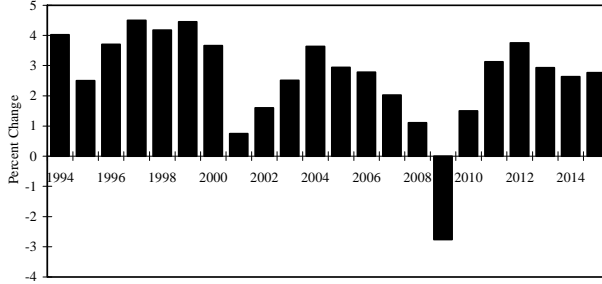
TABLE N. 2
U.S. Forecast Change - (Current Forecast Jul 2009 vs. Last Forecast Apr 2008)

	Quarterly				Annual								
	2009:2	2009:3	2009:4	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
GDP (Bil of 2000 \$) Chain Weight	11,299	11,317	11,347	11,524	11,652	11,331	11,500	11,860	12,305	12,666	13,000	13,360	13,742
% Change From Last Forecast	0.6	1.0	1.1	0.0	0.0	0.7	0.9	0.5	0.3	(0.1)	(0.2)	(0.1)	(0.0)
Personal Income (Bil of \$)	12,165	12,086	12,132	11,663.3	12,100.7	12,108.1	12,375.1	12,873.0	13,553.3	14,277.5	15,038.9	15,828.2	16,653.3
% Change From Last Forecast	0.0	(0.2)	(0.1)	0.0	(0.0)	(0.1)	0.3	0.4	0.5	0.4	0.1	0.1	0.1
Nonagricultural Employment (Millions)	132.2	131.4	131.0	137.6	137.0	132.1	131.4	133.5	136.7	139.5	141.4	142.9	144.5
% Change From Last Forecast	(0.1)	0.0	0.2	0.0	0.0	0.0	0.3	0.4	0.4	0.2	0.1	0.1	0.1
Unemployment Rate	9.3	9.8	10.1	4.6	5.8	9.3	10.2	9.7	8.8	8.1	7.7	7.4	7.0
% Change From Last Forecast	4.4	2.5	1.0	0.0	0.0	1.9	0.5	1.5	2.7	4.7	6.2	6.3	5.6
Industrial Production Index (2002=100)	96.2	97.2	97.8	111.3	108.8	97.6	99.1	103.2	108.5	112.6	115.8	119.2	122.7
% Change From Last Forecast	(1.9)	0.1	1.3	0.0	(0.0)	(0.1)	1.7	1.2	1.2	1.2	1.3	1.5	1.8
Corporate Profits (Bil of \$)	1,346.9	1,470.9	1,490.6	1,886.3	1,597.3	1,415.0	1,607.8	1,881.5	1,954.7	1,972.7	1,940.6	1,976.0	2,026.2
% Change From Last Forecast	2.1	10.3	8.3	0.0	0.0	6.1	0.8	2.9	3.8	3.9	4.0	4.1	4.9
Money Supply (M2) (Bil of \$)	8,318	8,416	8,520	7,382	7,992	8,520	8,967	9,503	9,980	10,422	10,858	11,363	11,943
% Change From Last Forecast	(0.9)	(1.4)	(1.6)	(0.0)	(0.3)	(1.6)	(1.4)	(1.1)	(1.3)	(1.6)	(1.9)	(2.0)	(2.0)
Prime Rate	3.25	3.25	3.25	8.05	5.09	3.25	3.33	4.70	6.34	6.55	7.59	7.75	7.75
% Change From Last Forecast	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Consumer Price Index (1982-84=100)	213.2	214.3	215.2	207.3	215.2	213.8	217.6	222.9	227.8	232.7	237.6	242.8	248.0
% Change From Last Forecast	0.6	1.0	1.2	0.0	0.0	0.7	0.9	1.3	1.1	0.9	0.8	0.6	0.5
Federal Budget (unified) (Bil of \$, Fed FY)	(333.8)	(474.8)	(393.9)	(187.9)	(680.5)	(1,651.4)	(1,156.9)	(853.3)	(717.2)	(569.6)	(626.5)	(687.7)	(710.8)
Current Account Balance (Bil of \$)	(418.1)	(504.9)	(583.1)	(726.6)	(706.1)	(478.0)	(639.1)	(685.3)	(742.5)	(733.3)	(718.2)	(700.3)	(690.0)
% Change From Last Forecast	21.6	23.3	24.7	(0.6)	4.9	17.7	17.5	6.0	(0.6)	(7.8)	(12.2)	(14.1)	(14.4)
Population (Millions)	308.0	308.7	309.5	302.41	305.37	308.36	311.37	314.38	317.41	320.48	323.58	326.70	329.84
% Change From Last Forecast	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

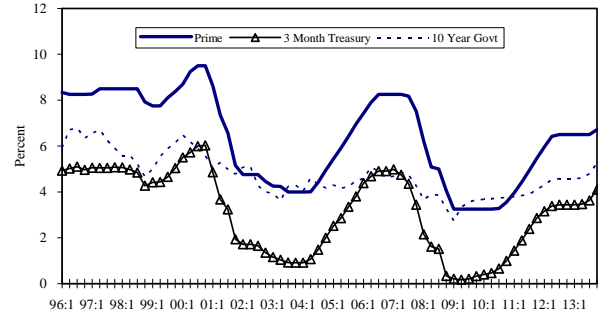
Graph N. 1

U.S. ECONOMIC HISTORY AND FORECAST

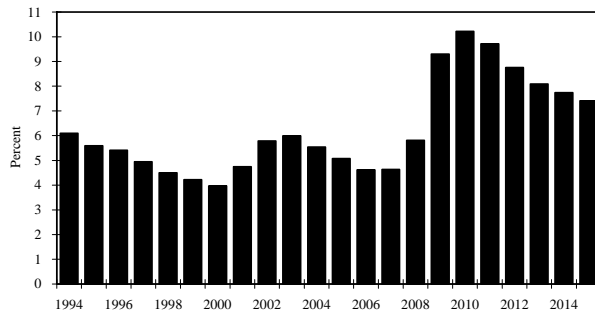
REAL GDP, PERCENT CHANGE
2000 DOLLARS, CHAIN WEIGHTED



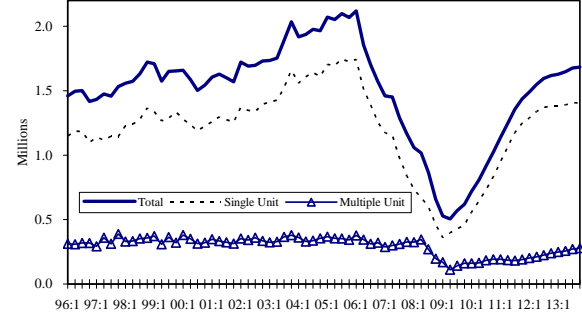
INTEREST RATES



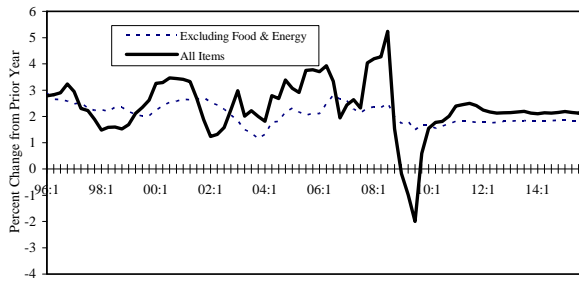
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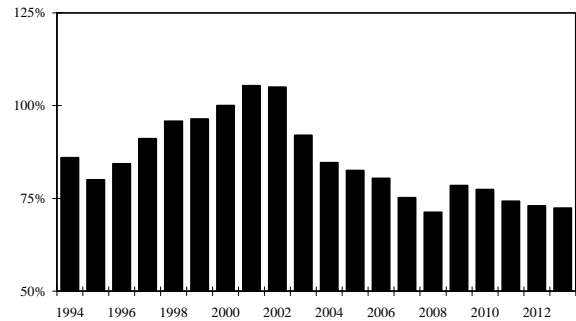
HOUSING STARTS



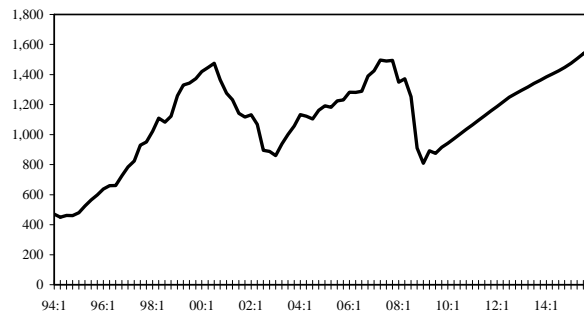
CONSUMER PRICE INDEX
ALL ITEMS VS. ALL ITEMS LESS FOOD & ENERGY



REAL EXCHANGE RATE



STANDARD & POOR'S 500 INDEX



CONSUMER CONFIDENCE & SPENDING

