SIFMA Mid-Year 2010 Economic Outlook

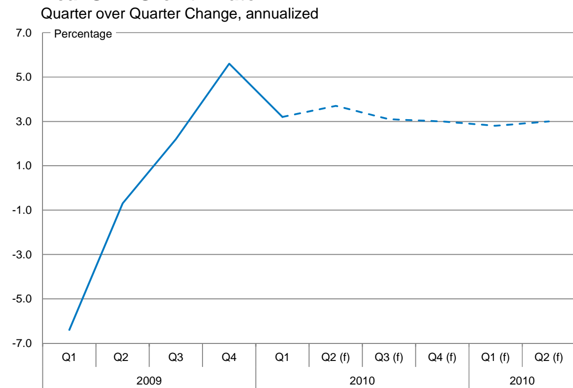
The Economic Outlook: Moderately Pessimistic

Members of the Securities Industry and Financial Markets Association's Economic Advisory Roundtable forecast that U.S. economic growth will continue to grow at a steady but unspectacular rate of 3.3 percent in 2010 and 3.1 percent in 2011.[1] The Roundtable panelists were restrained in their forecasts and demurred from predicting the level of rebound one might normally expect after a severe recession. The outlook warned of future challenges, particularly the impact of pending financial regulatory reform and potential missteps in fiscal and monetary policies such as tax policy.

Forecast Highlights

MONETARY POLICY The Roundtable was unanimous in its opinion that the Federal Open Market Committee (FOMC) would not change its current 0.0 to 0.25 percent target federal funds rate at the upcoming June 22-23 meeting. Expectations have shifted considerably since the December outlook, when panelists believed the FOMC would begin raising rates in mid-to-late 2010; the current survey found that only 12 percent of respondents expected a rate hike in 2010, while over half predicted that the FOMC will begin raising rates by mid-2011 and the remainder in late 2011 or the beginning of 2012.[2]

THE ECONOMY The median forecast called for gross domestic product (GDP) to rise 3.3 percent in 2010 on a year-over-year basis, and by 3.2 percent on a fourth quarter-to-fourth quarter basis.[3] On a quarterly basis, respondents expected GDP to rise 3.7 percent in the second quarter on an annualized basis, dropping slightly to 3 percent for the remainder of 2010. With a median forecast of 3.1 percent growth in GDP for 2011, economic growth was not expected to strengthen in the near-term.[4]



*(f) Forecast
Source: Actuals: Bureau of Economic Analysis; Forecasts: Median Response to the SIFMA Economic Advisory Roundtable Mid-Year 2010 Economic Outlook Survey

This level of economic growth, however, was expected to be insufficient to spur the level of job creation needed to significantly lower the unemployment rate, which was predicted to persist at an elevated rate throughout 2010 and 2011. Full-year 2010 nonfarm payroll employment gains were estimated to total 1.3 million jobs;[5] while job recovery estimates for 2011 ranged widely, the median expectation was for a somewhat stronger 2.3 million jobs.[6] Survey respondents expected the full-year average unemployment rate to be 9.6 percent in 2010, an upward revision from the 9.4 percent unemployment rate expected for 2010 in the end-year 2009 survey, and 8.9 percent in 2011.[7]

Median consumer spending, however, has been recovering somewhat and is forecast to grow at a 2.6 percent in full-year 2010 and 2011.[8]

---

[1] The survey was conducted from May 26 – June 11, 2010. The forecasts discussed in the text and appearing in the accompanying data table are the median values of the individual member firms' submissions, unless otherwise specified.

[2] The forecast for when the FOMC would begin raising rates ranged from third quarter 2010 to first quarter 2012.

[3] The full-year 2010 GDP growth forecasts ranged from 2.9 percent to 3.7 percent. On a quarterly basis, there was a wide range in annualized GDP growth estimates: 2.6 percent to 4.5 percent in 2Q'10; 1.5 percent to 4.8 percent in 3Q'10; and 1.5 percent to 4 percent in 4Q'10.

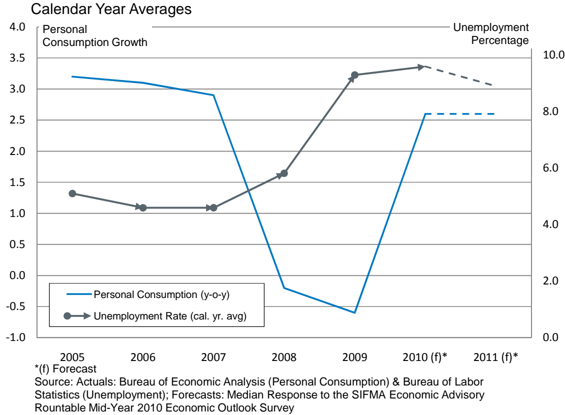
[4] The full-year 2011 GDP growth forecasts ranged from 2.2 percent to 3.8 percent. On a quarterly basis, 1Q'11 GDP estimates ranged from 2.0 to 3.9 percent, while 2Q'11 estimates ranged from 1.5 percent to 3.8 percent.

[5] The full-year 2010 payroll employment forecasts ranged from a loss of 600,000 jobs to the addition of 2.4 million jobs.

[6] The full-year 2011 payroll employment forecasts ranged from a gain of 200,000 jobs to a gain of 4.0 million jobs.

[7] The full-year 2010 average unemployment rate forecast was in a tight range of 9.4 percent to 9.9 percent and for 2011 ranged from 8.0 percent to 9.8 percent.

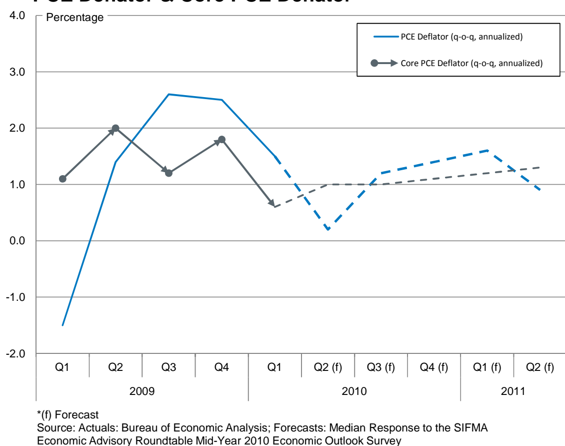
[8] The full-year 2010 consumer spending growth forecasts ranged from 2.2 percent to 3.2 percent and in 2011 ranged from 2.1percent to 3.0 percent.



*(f) Forecast
Source: Actuals: Bureau of Economic Analysis (Personal Consumption) & Bureau of Labor Statistics (Unemployment); Forecasts: Median Response to the SIFMA Economic Advisory Rountable Mid-Year 2010 Economic Outlook Survey

Business capital investment growth was expected to grow by 3.0 percent in full-year 2010, with a more robust 7.2 percent predicted for 2011.[9] State and local government spending was expected to shrink slightly by 1.4 percent in 2010 and remain flat in 2011, although forecasts for 2011 varied widely.[10]

The median forecast for "headline" inflation, measured by the personal consumption expenditures (PCE) chain price index, was 1.6 percent for full-year 2010 and 1.5 percent for full-year 2011.[11] The median forecast for the core PCE chain price index was 1.1 percent for full-year 2010 and 1.2 percent for full-year 2011.[12]



*(f) Forecast
Source: Actuals: Bureau of Economic Analysis; Forecasts: Median Response to the SIFMA Economic Advisory Roundtable Mid-Year 2010 Economic Outlook Survey

The inflation outlook continued to remain subdued against the background of modest economic retrenchment. Respondents were unanimous that inflation was not a concern in 2010; one respondent noted, "Money and credit are still languishing and banks are still shrinking; absent a stronger financial tailwind, inflation is a nonstarter." The sentiment stayed true through 2011: only one respondent characterized inflation as a serious worry, while half of the respondents believed inflation to not be a worry and the remainder as only a moderate concern.

While only a couple of respondents identified deflation as a risk, none named inflation as a near term risk. Pointing out that Fed accommodation has barely staved off serious deflation and money and credit growth stalled, the group was unanimous in their belief that inflation was, at best, a distant concern.

The Federal Reserve's expanded balance sheet has continued to raise some concern in the news but was generally considered a nonstarter among panelists. The expanded Fed balance sheet ranked fourth as a contributing factor to the inflationary outlook, behind economic slack and unemployment, global conditions, and fiscal policy/federal deficit trends. Other factors mentioned contributing to panelists' inflationary outlooks were weak housing markets and lack of credit growth.

INTEREST RATES As noted earlier, the Roundtable expected the Federal Reserve to continue maintaining its 0.0 to 0.25 percent federal funds target rate at the upcoming June meeting and for some time to come. As of June 11, the end of the survey period, the 10-year U.S. Treasury yield was 3.24 percent, down 49 basis point (bps) from end-March 2010 and 35 bps from end-December 2009. The median forecast for the June 2010 average 10-year Treasury note yield was 3.4 percent, rising to 3.75 percent in December and 4.1 percent in June 2011.[13] Credit market risk aversion, economic growth prospects and inflation/inflationary expectations were cited as the three most important drivers of the Treasury yields outlook; budget deficit trends, FOMC interest rate policy and the dollar were also identified as important, albeit lesser, influences.

---

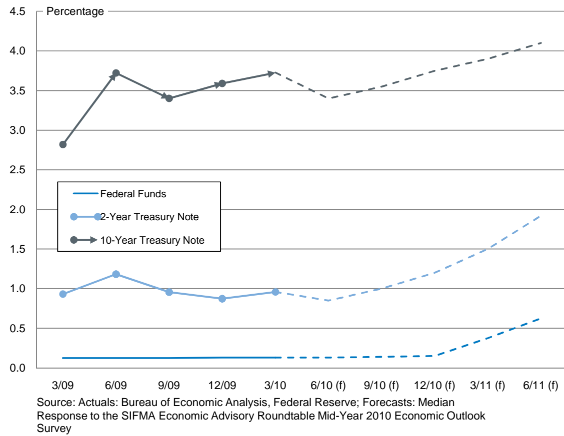
[9] The full-year 2010 business fixed investment forecasts ranged from 1.0 percent to 5.5 percent and for 2011 ranged from 1.0 percent to 12.6 percent.

[10] The full-year 2010 real state and local government spending forecasts ranged from negative 2.6 percent to positive 0.1 percent and for 2011 from negative 2.6 percent to a positive 1.9 percent.

[11] The full-year 2010 PCE deflator forecasts ranged from 0.9 percent to 1.9 percent and for 2011, from 0.5 percent to 2.2 percent.

[12] The full-year 2010 core PCE deflator forecasts ranged from 0.8 percent to 1.4 percent and for 2011, from 0.4 percent to 1.8 percent.

[13] The average 10-year Treasury yield forecasts ranged from 3.20 percent to 3.75 percent for June 2010; from 3.25 percent to 4.50 percent for December 2010; and from 3.50 percent to 5.10 percent for June 2011.



Survey respondents were split over the future shape of the Treasury yield curve: over half the respondents expected it to steepen between now and year-end 2010, with the remainder evenly split between the curve flattening or staying unchanged. Over half the respondents expected the TED spread (Treasury bill less LIBOR rate) to remain unchanged during the next six months, with 35 percent expecting the spread to narrow and the remaining minority expecting wider spreads.

Investment-grade credit spreads were expected to narrow over the next six months by 65 percent of respondents, with the remainder expecting no change. High-yield credit spreads expectations yielded a relatively similar outlook: approximately 65 percent of respondents expected spreads to narrow by year-end 2010; 24 percent expected no change in spreads; and the remainder, wider spreads.

Monetary Policy: Hold or Sell?

The survey asked a number of questions about both conventional and unconventional monetary policy. On the conventional side, respondents predicted that the Federal Reserve would not begin raising its target rate before early-to-mid 2011, with predictions ranging from 3Q'10 to 1Q'12.[14] Whether the key driver to determining the target rate was job creation, the unemployment rate or core inflation, it was generally agreed that the Fed needed to see evidence of reliable, self-sustaining economic activity levels to ensure avoidance of a "double-dip" recession.

On the topic of unconventional policies, respondents were asked to consider the FOMC's April discussion of strategies for normalizing the Fed's expanded balance sheet. The FOMC debated the potential speed and breadth of agency debt and mortgage-backed securities sales, with the majority preferring to defer asset sales until after the first increase in the target Fed Funds rate.[15] Three quarters of survey respondents agreed with the Fed's conclusion, with the remainder split between advocating an earlier start date or preferring to defer judgment entirely on timing.

When asked about their recommendations for the timeframe of the drawdown of the Fed's portfolio, the general consensus was for over a very long time period. Over 70 percent of those surveyed preferred a drawn-out reduction of the Fed's portfolio, advocating sales over a period of five years to a full run off. The remaining respondents advocated for a slightly faster pace (three years) or recommended allowing the Fed to take their time depending on market conditions.

The FOMC did not come to a conclusion regarding its longer-term strategy for asset sales at the April meeting. When asked about their preferred strategies for management of the Fed's portfolio, survey respondents included shortening duration as markets stabilized, reverse repos and term deposits for depository institutions, although none were in a rush to begin implementation.

Business and Credit Market Adjustments Dominant in Promoting U.S. Growth

The self-correcting adjustments by business and real estate markets and the normalization of private credit markets were again ranked as the two most important factors supporting U.S. economic growth. Global economic conditions, however, moved into third place, followed by Federal Reserve interest rate policy and unconventional support coming in last. Other factors mentioned were the lagged impact of fiscal stimulus and the stock market's recovery.

Unrecognized pent-up demand and stronger than expected employment growth were the dominant upside risks to the economic forecasts, followed by the general cyclical recovery dynamics and export growth. Honorable mentions went to technological breakthroughs, lower oil prices and regional bank recovery leading to more small business lending and hiring.

Spillover from worsening European economic conditions and financial markets was by far the most oft-cited risk on the downside, followed by general concern over political and tax policy missteps and stock market weakness/volatility. Weakening wage growth, further housing market declines and energy price spikes were distant runners-up.

Fiscal Policy: Mini-Stimulus

Commenting on potential future stimulus programs, respondents were evenly divided over the currently

[14] Note contrast to Dec survey results

[15] See "Minutes of the Federal Open Market Committee, April 27-28, 2010," pp.2-3.

pending mini-stimulus package. Those expecting such a package to pass believed it would likely include an extension of unemployment benefits, other targeted job-oriented programs, and expanded support for state and local governments, among other possible measures. Such measures were generally expected to have a positive, albeit modest, impact. One respondent pointed out that even with additional stimulus, fiscal support will have moved from positive in 2009 to neutral in 2010 to slightly restrictive in 2011.

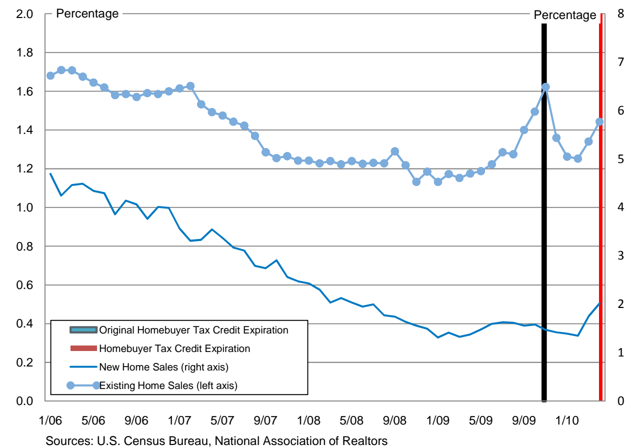
Sunset of Tax Cuts/Tax Increases a Further Drag

On the other side of the fiscal policy coin are tax increases on the horizon, both anticipated and potential. Foremost are dividend and capital gains taxes, slated to sunset at the end of 2010. While both taxes are currently at 15 percent, capital gains were taxed at 20 percent and dividends at the marginal tax rate prior to the 2001 and 2003 personal tax cuts. Several alternatives are currently under consideration by Congress and the Administration, but all were rated as negative or severely negative in terms of impact on economic growth by a significant majority.

Other tax proposals such as a financial transaction tax and surtax on financial sector workers were also criticized as negative. While a bank tax was expected to have a negative economic impact in any form, a balance-sheet based tax was identified as more damaging than a revenue-based bank tax.

Has Housing Already Reached Bottom?

When asked to predict when several housing indicators would hit bottom, respondents were generally in agreement. Housing sales were generally agreed to have to have hit bottom in mid-2009, with 94 percent expecting sales to bottom by the end of 3Q'10. Housing starts were also seen to have reached bottom in 2Q'09, with all forecasts no later than year-end 2010.



Employment Outlook

The employment outlook continued to be fairly negative in the near-term, with nearly 60 percent forecasting that the U.S. economy would not begin adding jobs at a significant pace until at least the second half of 2010, and a significant minority not expecting accelerated job growth until at least well into 2011. While the unemployment rate has been distorted by the repeated extension on benefits, respondents believe unemployment will decline only slightly on average in 2011 than in 2010, falling to 8.9 percent from 9.6 percent.

Oil Prices: Unlikely Risk Up or Down

Panelists placed a greater than 60 percent chance on oil prices remaining in the $60 - $90 per barrel range for the rest of 2010. The chance of oil prices moving above or below that range were evenly split compared to the clear upside bias in the end-2009 survey.[16] The $90+/barrel scenario would have the estimated effect of reducing GDP growth by approximately one-half percentage point, similar to the drag predicted previously; the sub-$60/barrel scenario envisioned a GDP increase of roughly 63 bps, compared to 35 bps in December 2009.[17]

[16] See SIFMA End-Year 2009 Economic Outlook, December 2009

[17] The estimated positive impact of lower oil prices (below $60 per barrel) on GDP growth ranged from 20 to 180 basis points, while the negative impact of higher oil prices (above $90 per barrel) ranged from 20 to 140 basis points less growth. The middle price range ($60 to $90 per barrel was expected to have no appreciable impact on GDP growth.

Financial Regulatory Reform

Respondents were asked a series of questions regarding the financial regulatory reform legislation currently in the House and Senate conference committee. While the major thrust of the questions was to understand the expected economic impact of certain aspects regulatory reform, respondents also shared more general qualitative comments.

While supporting the intent of regulatory reform, there was clear concern that the overall impact on economic growth would be negative, ultimately making credit more expensive and more difficult to acquire. Some noted that such costs could be justified to build a more solid financial foundation over the long term, although one commentator countered that "even if Congress gets it all right, financial regulatory reform will reduce credit availability and hurt growth." Another respondent stated bluntly that regulatory reform would delay economic recovery by six months to a year.

While the final form of the regulatory reform bill is still unknown, the swaps push out contained in the Lincoln amendment to the Senate bill and the prohibition of trust preferred securities as Tier 1 capital as contained in the Collins amendment were cited as the two most onerous provisions in terms of negative economic impact. The cumulative costs of compliance with new and forthcoming regulation, industry assessments and other requirements were also identified as having negative economic impacts.

Ill-wind Blows Across the Atlantic

Most respondents expect, on net, little direct impact from euro area weakness, with the negative, if minimal, impact to U.S. exports (due to the relatively small share that Europe represents) balanced by the positive offset of lower interest rates due to flight to safety.

However, while direct impact of the euro area weakness was considered minimal to the U.S. economy, headwinds were noted from indirect effects, particularly if current conditions were to worsen into severe global credit market instability or translate into tighter financial conditions. It was generally noted, however, that it would take a much more severe credit event than experienced in the euro area to have a meaningful impact here.

SIFMA ECONOMIC OUTLOOK

SIFMA Economic Advisory Roundtable Forecast

Inflation adjusted year-over-year percentage change, unless otherwise specified.

	2010	2011
Real GDP	3.3	3.1
Real GDP (4Q – 4Q)	3.2	N/A
CPI	1.7	1.4
CPI (4Q – 4Q)	0.8	N/A
Core CPI	1.0	1.2
Core CPI (4Q – 4Q)	0.7	N/A
PCE deflator	1.6	1.5
PCE deflator (4Q – 4Q)	1.0	N/A
Core PCE deflator	1.1	1.2
Core PCE deflator (4Q – 4Q)	0.9	N/A
Personal Consumption	2.6	2.6
Nonresidential Fixed Investment	3.0	7.2
Housing Starts (millions)	0.7	0.8
Real State & Local Government Spending	(1.4)	0
Current Account Deficit ($ billions)	499.4	540.0
New Home Sales (millions of units)	0.4	0.5
Existing Home Sales (millions of units)	5.3	5.6
Nonfarm Payroll Employment (change in millions)	1.3	2.3
Unemployment Rate (calendar year average)	9.6	8.9
S&P 500 Index Price (year-end)	1,225.0	1301.0
Federal Budget (FY, $ billions)	(1,300.0)	(1,100.0)

Quarter-to-Quarter % Changes in Annual Rates

	2010				2011	
	I	II	III	IV	I	II
Real GDP	3.0	3.7	3.1	3.0	2.8	3.0
CPI	0.9	(0.4)	1.2	1.5	1.5	1.1
Core CPI	(0.2)	0.7	1.0	1.2	1.2	1.2
PCE deflator	1.5	0.2	1.2	1.4	1.6	0.9
Core PCE deflator	0.6	1.0	1.0	1.1	1.2	1.3
Personal Consumption	3.5	3.2	2.8	2.8	2.5	2.8
Nonresidential Fixed Investment	3.1	6.9	6.9	7.8	7.5	7.7

Interest Rates (monthly average %)

	Jun. 10	Sep. 10	Dec. 10	Mar. 11	Jun. 11
Fed Funds	0.1	0.1	0.2	0.4	0.6
2 Year Treasury Note	0.9	1.0	1.2	1.5	1.9
10 Year Treasury Note	3.4	3.6	3.8	3.9	4.1
30 Year Fixed-Rate Home Mortgages	4.9	5.0	5.1	5.3	5.4

Exchange Rates (monthly average %)

	Jun. 10	Sep. 10	Dec. 10	Mar. 11	Jun. 11
Yen/Dollar	92	94	95.3	96	98
Dollar/Euro	1.2	1.2	1.2	1.2	1.2

SIFMA ECONOMIC OUTLOOK

SIFMA Economic Advisory Roundtable 2010 Members

John Silvia (Chair)
Wells Fargo

Ethan Harris
Bank of America Merrill Lynch Research

Robert DiClemente
Citigroup

Michael Moran
Daiwa Securities America Inc.

Christopher Low
FTN Financial

James Glassman
J.P. Morgan Chase & Co.

John Lonski
Moody's Analytics, Inc.

David H. Resler
Nomura Securities International, Inc.

Scott J. Brown
Raymond James & Associates, Inc.

David Wyss
Standard & Poor's Rating Services

Dean Maki
Barclays Capital Inc.

Neal Soss
Credit Suisse

Peter Hooper
Deutsche Bank Securities Inc.

Jan Hatzius
Goldman, Sachs & Co.

Diane Swonk
Mesirow Financial, Inc.

Richard B. Berner
Morgan Stanley & Co. Inc

Stuart Hoffman
PNC Financial Services Group

Stephen Gallagher
Societe Generale Corporate and Investment Banking

Maury Harris
UBS Securities, LLC

SIFMA Staff Advisor
Kyle Brandon
Managing Director, Director of Research

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

Disclaimer
The Securities Industry and Financial Markets Association (SIFMA) prepared this material for informational purposes only. SIFMA obtained this information from multiple sources believed to be reliable as of the date of publication; SIFMA, however, makes no representations as to the accuracy or completeness of such third party information. SIFMA has no obligation to update, modify or amend this information or to otherwise notify a reader thereof in the event that any such information becomes outdated, inaccurate, or incomplete.