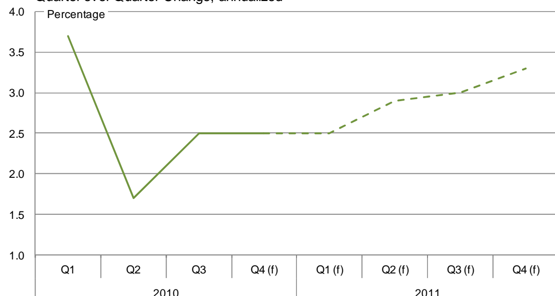
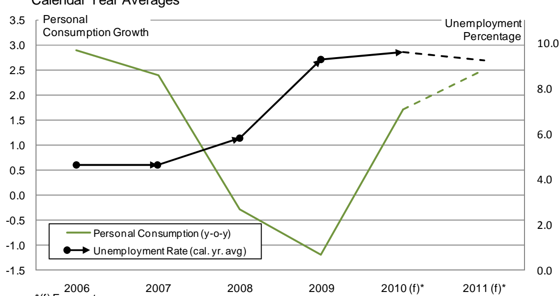
U.S. ECONOMIC OUTLOOK WEAKENS

Real GDP Growth Rate
Quarter over Quarter Change, annualized



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

Consumer Spending Growth Rate and Unemployment Rate
Calendar Year Averages



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

Members of the Securities Industry and Financial Markets Association's Economic Advisory Roundtable forecast that U.S. economic growth will grow at subdued rate of 2.8 percent in 2010 and 2.6 percent in 2011.[1] This outlook is weaker than at mid-year, when the Roundtable predicted growth rate of 3.3 percent and 3.1 percent in 2010 and 2011, respectively. While there was some belief that a rebound in job growth and consumer and business confidence could jumpstart a stronger growth pace, concerns over fiscal policy, continued weakness in housing and mortgage markets, European sovereign debt concerns, regulatory uncertainties, and fiscal problems are significant risks to the downside.

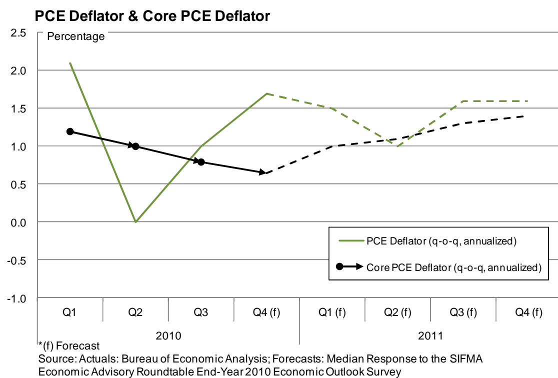
Forecast Highlights

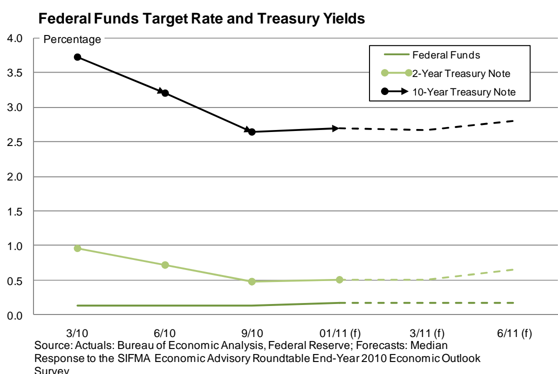
MONETARY POLICY The Roundtable was unanimous in its opinion that the Federal Open Market Committee (FOMC) would not change its current 0.0 to 0.25 percent target federal funds rate at the upcoming December 14 meeting. Expectations for rate hikes by the FOMC have shifted since our mid-year survey[2] when over 60 percent of respondents expected a rate hike by mid-2011; the current survey found that only 21 percent of respondents predicting a date expect a rate hike in 2011, 47 percent in 2012, and the balance percent in 2013 and beyond.[3] Respondents who did not put a date to rate hikes opined that the timing of future rate hikes was primarily dependent on two factors: improvement in employment growth, and a reduction in deflation risk.

THE ECONOMY The median forecast called for gross domestic product (GDP) to rise 2.8 percent in 2010 on a year-over-year basis, and by 2.6 percent on a fourth quarter-to-fourth quarter basis.[4] On an annualized basis, respondents expected GDP to rise 2.5 percent in the fourth quarter of 2010.[5] For 2011, the median forecast of 2.6 percent year-over-year growth was expected; GDP was expected to steadily rise from a 2.5 percent annualized rate in the first quarter of 2011 to a 3.3 percent growth rate in the fourth quarter.[6]

Unemployment was expected to remain at significantly elevated levels throughout 2010 and 2011. Survey respondents expected the full-year average unemployment rate to remain at 9.6 percent in 2010 and decline slightly to 9.2 percent in 2011.[7] Full-year 2010 nonfarm payroll employment gains were estimated to total 1.1 million jobs;[8] while job recovery estimates for 2011 ranged widely, the median expectation was for a somewhat stronger addition of 2.1 million jobs.[9] Consumer spending trends were expected to mirror employment growth, with personal consumption estimated to rise by 1.7 percent in 2010 and improve modestly to 2.5 percent in 2011.[10]

[1] The survey was conducted from November 17 – December 1, 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 mid-year 2010 Economic Outlook report is available at: http://www.sifma.org/research/item.aspx?id=19153.
[3] The forecast for when the FOMC would begin raising rates ranged from second quarter 2011 to the third quarter of 2013.
[4] The full-year 2010 GDP growth forecasts ranged from 2.3 percent to 2.9 percent and on a fourth-quarter-to-fourth quarter basis ranged from 2.4 percent to 2.9 percent.
[5] On a quarterly basis, annualized GDP growth forecasts ranged from 1.5 percent to 3.5 percent in 4Q'10.
[6] The full-year 2011 GDP growth forecasts ranged from 1.8 percent to 3.3 percent. On a quarterly basis, GDP forecasts ranged from 1.9 percent to 3.5 percent in 1Q'11; 2.0 percent to 3.7 percent in 2Q'11, 1.8 percent to 3.9 percent in 3Q'11, and 1.5 percent to 4 percent in 4Q'11.
[7] The full-year 2010 average unemployment rate forecast was in a tight range of 9.5 percent to 9.7 percent and for 2011 ranged from 8.5 percent to 9.7 percent.
[8] The full-year 2010 non-farm payroll employment forecasts ranged from a gain of 800,000 jobs to 1.4 million jobs.
[9] The full-year 2011 non-farm payroll employment forecasts ranged from a gain of 1.3 million jobs to a gain of 2.5 million jobs.
[10] Personal consumption forecasts ranged from 1.7 percent to 2.7 percent in 2010 and 1.6 percent to 3.5 percent in 2011.





Business capital investment growth was expected to rise by 5.8 percent in full-year 2010, with a more robust 8.5 percent predicted for 2011.[11] State and local government spending was expected to shrink by 1.3 percent in 2010 and continue shrinking by an additional 0.1 percent in 2011.[12]

The median forecast for "headline" inflation, measured by the personal consumption expenditures (PCE) chain price index, was 1.7 percent for full-year 2010 and 1.4 percent for full-year 2011.[13] The median forecast for the core PCE chain price index was 1.4 percent for full-year 2010 and 1.1 percent for full-year 2011.[14]

The outlook for inflation weakened against the background of modest economic growth expectations. Most respondents (85 percent) did not believe inflation to be a concern in 2011, with the remaining 15 percent moderately concerned. Economic slack/unemployment was cited as the top factor in the 2011 inflation outlook, followed by global conditions, fiscal policy/deficit trends and Fed balance sheet expansion. While there has been considerable media speculation over the risks of the Fed continuing to expand its balance sheet, most respondents were unconcerned, with one noting that "monetary transmission is impaired and financial headwinds nullify [Fed] accommodation."

Sentiment shifts, however, when looking to the more distant future; while 60 percent of respondents reported no worry about inflation in 2012, 40 percent expressed moderate to strong concern. The future course of inflation remains a hotly debated topic: one respondent noted, "deflation is still a risk in the U.S., though it won't be obvious until the second half of next year, after the dollar stabilizes," while another wrote, "inflation expectations are rising again and bear close watching."

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 December meeting and for some time to come. As of December 1, the end of the survey period, the 10-year U.S. Treasury yield was 2.97 percent, up from a 2010 low of 2.41 percent in early October but 88 basis points (bps) below the 3.85 percent end-December 2009 level. The median forecasts for 10-year Treasury rates in 2011 were 2.7 percent for March, rising to 2.8 percent in June, 3.0 percent in September, and 3.3 percent in December.[15]

Over half the survey respondents expected the Treasury yield curve to steepen between now and end-June 2011, with 35 percent expecting the curve to flatten and the balance expecting the curve to remain unchanged. The majority of the respondents (63 percent) expected the TED spread (Treasury bill less LIBOR rate) to remain unchanged during the next six months, with the balance evenly split between widening or narrowing spreads.

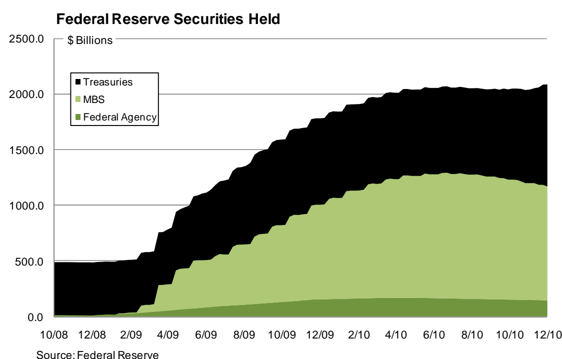
[11] The full-year 2010 business fixed investment forecasts ranged from 5.2 percent to 6.2 percent and for 2011 ranged from 5.1 percent to 13.0 percent.
[12] The full-year 2010 real state and local government spending forecasts ranged from negative 1.5 percent to negative 1.0 percent and for 2011 from negative 2.0 percent to a 0.9 percent.
[13] The full-year 2010 PCE deflator forecasts ranged from 1.1 percent to 1.8 percent and for 2011, from 0.0 percent to 1.8 percent.
[14] The full-year 2010 core PCE deflator forecasts ranged from 0.9 percent to 1.4 percent and for 2011, from 0.3 percent to 1.5 percent.
[15] The average 10-year Treasury yield forecasts ranged from 2.3 percent to 3.0 percent for January 2011, 2.0 percent to 3.3 percent for March 2011, from 2.0 percent to 4.0 percent for June 2011, from 2.3 percent to 4.5 percent for September 2011, and from 2.0 percent to 5.0 percent in December 2011.

Investment-grade credit spreads were expected to continue narrowing over the next six months by 70 percent of respondents, with the remainder expecting no change. High-yield credit spreads expectations yielded a similar outlook.: 74 percent of respondents expected spreads to narrow over the next six months, while 11 percent expected no change; the balance of respondents, however, expected high-yield corporate spreads to widen compared to no prediction of widening of investment grade spreads.

Monetary Policy: QE2

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 begin raising its target rate in 2Q'12, with predictions ranging from 2Q'11 to 3Q'12. More so than in previous surveys, the recovery of core inflation joined job creation and the unemployment rate as key drivers in the FOMC's decision making process.

On November 3, 2010, the FOMC announced it would expand its holdings of securities through a second round of quantitative easing, popularly dubbed "QE2", in order to pursue two purposes: to promote a stronger pace of economic recovery and help ensure inflation at a level consistent with the Fed's mandate. Specifically, the FOMC stated that it would maintain its current policy of reinvesting principal payments from its securities holdings and that it intends to purchase an additional $600 billion in longer term Treasury securities by the end of the second quarter of 2011, a pace of about $75 billion per month.



Survey participants were asked about their expectations of impact of QE2 on several key economic indicators by mid-2011. The impact on 10-year Treasury yields was predicted to be relatively minor, with 65 percent estimating a drop in rates of zero to 25 bps, while 20 percent expected a drop of 25 to 50 bps; taking the contrary view, 15 percent believed rates would rise between zero and 50 bps. There was greater accord on its impact on unemployment: 75 percent of respondents expected no impact on the unemployment rate, while 25 percent predicted a drop of one percentage point. The Roundtable was unanimous in its opinion that there would be no impact on inflation. Most respondents (75 percent) predicted a negative impact on the U.S. dollar of five percent, with the remaining 25 percent expecting no impact.

Economic Growth

The normalization of private credit markets and self-correcting adjustments by business and real estate 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 pull back in regulation and extending tax cuts, as well as fiscal policy generally.

The return of business confidence ("animal spirits") and spending were the dominant upside risks to the economic forecasts, followed higher than expected employment and income growth and normalization of financial markets and credit. A return of consumer confidence and strong demand for exports were also mentioned.

Contagion from the European sovereign debt crisis, U.S. economic conditions and global financial markets were the most oft-cited risks to the downside, followed by non-extension of the Bush tax cuts and excessive fiscal tightening. A surge in oil prices was frequently noted as a potential risk, with further housing market declines and state and local governments remaining a fiscal drag also mentioned.

Tax Policy

Respondents were asked about the impact of a potential changes in capital gains and dividend taxes as the current 15 percent rates for both are set to expire on December 31. Almost all respondents believe that a full return to marginal tax rates for capital gains and dividends would be negative (40 percent) or very negative growth (50 percent), with only 10 percent expecting no impact. The impact of the Obama budget scenario (a rise to 20 percent for families making over $250,000/individuals making over $200,000 and unchanged for those making less) was viewed less negatively with five percent expecting a very negative and 70 percent a negative impact, while 25 percent were neutral. A partial return to pre-2001 rates (capital gains tax rate rises to 20% and dividends tax rate rises to marginal rates for families making over $250,000/individuals$200,000; both remain at 15% for those making less) was judged to be about the same negative impact as the Obama budget proposal.[16]

Mid-term Election Results

Asked whether the results of the mid-term election would improve the policy outlook over the next six to 12 months, two-thirds of respondents agreed, with the most frequently cited improvements being the greater possibility of a full extension of current rates and the reduced risk of major legislation that raises costs to business. Of the remaining third who disagreed, several noted the uncertainty of gridlock would be a negative.

Deficit Reduction Debate

Respondents were unanimous in their opinion that deficit reduction is very important to the long-term health on the U.S. economy. There was some divergence in opinion, however, as to timing. Near-term there was concern that a too rapid tightening of fiscal policy while the economy is still weak would be a great risk to growth. However, it was also mentioned that a plan for deficit reduction was needed soon to address structural imbalances that would be crippling in the medium- to long-term.

Survey respondents noted that the consequences of not doing enough to reduce deficits would result in higher interest rates and persistently slower growth, with a much more difficult an adjustment in the future if put off. The current fiscal situation in Europe was cited as a possible view of the future if the U.S. did not bring deficits into line and address the long term mismatch between mandatory outlays and revenues. While there was less concern about doing too much – especially on the spending side - there was concern that tax hikes could threaten both personal consumption and business investment, dampening the pace of any recovery.

Roughly half of respondents considered the National Commission on Fiscal Responsibility and Reform ("Deficit Commission") report[17] very important. Although none expected it to be passed by the super majority of 14 (and it was not), most thought it important as a framework – or at least as proof that reasonable people can come to agreement on deficit reduction. However, a number of respondents pointed out that while it might help frame debate, it was considered "dead on arrival" and would be ignored like dire warnings in the past. While one participant pointed out that it was "more important than recognized, voters are ready for change," another reminded that "all the options have been discussed before, [the U.S.] need[s] political will, not another study commission."

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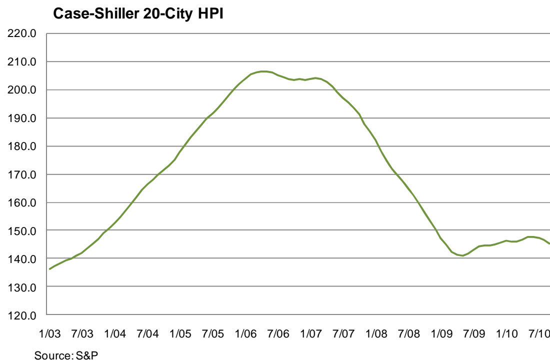
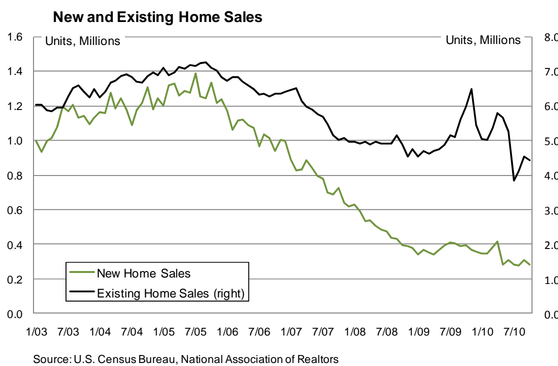
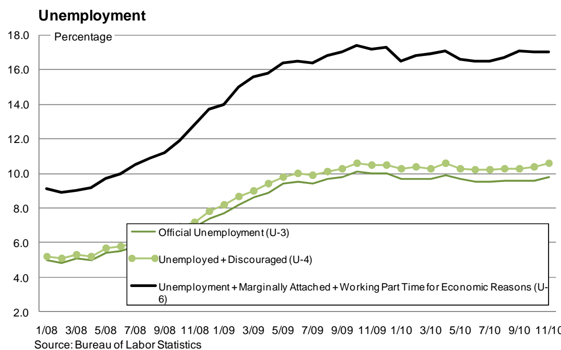
[16] Subsequent to this survey, President Obama announced an agreement to extend all tax cuts, December 6, 2010, "Statement by the President on Tax Cuts and Unemployment Benefits".

[17] National Commission on Fiscal Responsibility and Reform, "The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, December 1 2010.







Housing Finance Policy

Securitization, which is of central concern to housing finance and the economically significant housing sector, has moved front and center in the Dodd Frank regulatory rule making as well as the long-standing debate over the government's role in the mortgage market. Nearly all participants answering the question identified restarting the private (non-agency) securitization market as important or very important to the health of the U.S. economy.

When asked to predict when several housing indicators would hit bottom, respondents were generally in agreement. Housing sales were generally considered to have to have hit bottom this year, with 74 percent expecting sales to bottom by the end of 2010 and the reminder by mid-2011. This is more pessimistic than had been predicted in June when 94 percent predicted housing sales would bottom no later than 3Q'10. Projections on housing starts were also more negative this survey compared to mid-year. In June all respondents predicted housing starts would reach bottom no later than year-end 2010; this survey found that 68 percent believed they would bottom by year-end, while 32 percent predicted a bottom no later than mid-year 2011.

Employment Outlook Remains Weak

The employment outlook continued to be negative in the near-term, although less so than in the mid-year survey. Just over 70 percent forecast the U.S. economy has or would be adding jobs at a faster pace by the end of this year with remainder predicting sometime in 2011. The year-end outlook was more positive than during mid-year, when only 60 percent expected acceleration in job growth in the second half of 2010. On the flip side, , the median outlook for 2011 non-farm payroll employment growth (2.1 million jobs) was a bit lower than in June (2.3 million), although the range of forecasts was notably tighter.[18]

The unemployment rate was predicted to remain elevated at 9.2 percent in 2011 compared to the 2010 year-end forecast of 9.6 percent. Unlike job growth predictions, the unemployment rate forecast of 9.2 percent for 2011 is weaker that the mid-year survey's forecast of 8.9 percent. The unemployment rate alone, however, may not paint a complete picture of the very weak current employment conditions and may also be influenced by changes in the very high number of those considered discouraged, marginally attached[19] or those working part-time involuntarily.

Oil Prices: Most Likely Range-Bound

Panelists placed a greater than 50 percent chance on oil prices remaining in the $75 - $100 per barrel range in 2011. The chance of oil prices moving above or below that range were split, with 25 percent predicting prices would be below $75 per barrel and 20 percent predicting above $100. This percentage splits are similar to prior surveys, although ranges are somewhat wider.. The $100+/barrel scenario would have the estimated effect of reducing GDP growth by approximately one-half a percentage point, while the sub-$75/barrel scenario envisioned a GDP increase of roughly 40 basis points (bps). The most likely scenario – remaining in the $75 to $100 range - was

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[18] The range of 2011 non-farm payroll employment growth was 1.3 million to 2.5 million in this survey compared with 200,000 to four million in the June survey.

[19] "Marginally attached" are persons not currently looking for work and hence not counted as unemployed, but indicate some level of labor force attachment: individuals must currently want a job, have looked for work in the last 12 months, and are available for work. "Discouraged" workers are a subset of the "marginally attached" labor force. Bureau of Labor Statistics.

predicted by most respondents to be neutral to their GDP outlooks. Most forecasts conformed to the general belief that lower oil prices are a plus for consumers, while higher prices would dampen the pace of economic recovery. One respondent forecast that because QE2 would be negative for the dollar, it would, however, boost commodity prices, which in turn would impact consumption; price relief was expected when QE2 ends in the second half of 2011.

Financial Regulatory Reform

The Roundtable was asked about their views on the impact of implementation of the Dodd Frank Wall Street Reform and Consumer Protections act ("Dodd-Frank Act") on the U.S. economy and markets. Responses ranged from "not much" to "negative" to "positive" in the longer-term as it leads to "stronger financial institutions" and "more stability." There was a general theme that the Dodd-Frank Act has and would continue to contribute to slower consumer credit growth, which might translate as a small negative for growth. It was also noted that there was considerable room for interpretation in rule-making and therefore uncertainty also weighed on financial activity levels. A few respondents added that there would be little impact on economies or markets outside the U.S., although it would present a competitive loss for U.S. financial firms and markets.

Systemic risk regulation/capital standards and securitization/risk retention were overwhelmingly chosen as the provisions of Dodd-Frank that present the greatest risks to the U.S. economy if improperly implemented. The "Volcker Rule," (both proprietary trading and investment management), OTC derivatives and fiduciary standards were also identified as potential negatives for the economy. Half of the respondents cited derivative end-user margin requirements and swap dealer registration exceptions for regional banks and dealers as important Dodd-Frank provisions requiring legislative correction to avoid negative impact on the economy. Credit rating agency liability and risk retention requirements were also cited.

Regulatory uncertainty overall was believed to have had a negative impact on U.S. economic growth over the last six months; 88 percent of respondents noted a zero to one percent drag on the economy, with the remaining 12 percent thought greater than one percent.

SIFMA ADVISORY ROUNDTABLE FORECAST

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

	2010	2011
Real GDP	2.8	2.6
Real GDP (4Q – 4Q)	2.6	3.0
CPI	1.6	1.5
CPI (4Q – 4Q)	1.1	1.5
Core CPI	1.0	1.0
Core CPI (4Q – 4Q)	0.6	1.1
PCE deflator	1.7	1.4
PCE deflator (4Q – 4Q)	1.2	1.4
Core PCE deflator	1.4	1.1
Core PCE deflator (4Q – 4Q)	0.9	1.2
Personal Consumption	1.7	2.5
Nonresidential Fixed Investment	5.8	8.5
Housing Starts (millions)	0.6	0.7
Real State & Local Government Spending	(1.3)	(0.1)
Current Account Deficit ($ billions)	497.7	515.0
New Home Sales (millions of units)	0.3	0.4
Existing Home Sales (millions of units)	4.8	5.0
Nonfarm Payroll Employment (change in millions)	1.1	2.1
Unemployment Rate (calendar year average)	9.6	9.2
S&P 500 Index Price (year-end)	1,203.0	1,312.5
Federal Budget (FY, $ billions)	(1,294.0)	(1,187.5)

Quarter-to-Quarter % Changes in Annual Rates

	2010				2011			
	I	II	III	IV	I	II	III	IV
Real GDP	3.7	1.7	2.5	2.5	2.5	2.9	3.0	3.3
CPI	0.8	(1.6)	2.8	2.2	1.6	1.1	1.6	1.8
Core CPI	0.0	1.2	0.8	0.4	1.0	1.0	1.1	1.3
PCE deflator	2.1	0.0	1.0	1.7	1.5	1.0	1.6	1.6
Core PCE deflator	1.2	1.0	0.8	0.7	1.0	1.1	1.3	1.4
Personal Consumption	1.9	2.2	2.8	2.5	2.4	2.5	2.7	2.8
Nonresidential Fixed Investment	7.8	17.2	10.3	8.1	7.8	7.4	8.3	8.7

Interest Rates (monthly average %)

	Jan. 11	Mar. 11	Jun. 11	Sep. 11	Dec. 11
Fed Funds	0.2	0.2	0.2	0.2	0.2
2 Year Treasury Note	0.5	0.5	0.7	0.8	1.0
10 Year Treasury Note	2.7	2.7	2.8	3.0	3.3
30 Year Fixed-Rate Home Mortgages	4.3	4.3	4.4	4.6	4.8

Exchange Rates (monthly average %)

	Jan. 11	Mar. 11	Jun. 11	Sep. 11	Dec. 11
Yen/Dollar	83.00	83.00	84.00	85.50	86.90
Dollar/Euro	1.33	1.35	1.35	1.34	1.30

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