THE BOND MARKET ASSOCIATION
EconomicOutlook
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The Economic Outlook: U.S. Economy is Poised for Recovery

Summary
The Bond Market Association Economic Advisory Committee predicts in its mid-year forecast that the U.S. economy is likely to pickup speed later this year. Economic growth is expected to accelerate in the third and fourth quarters of 2001, with the strongest gains anticipated in 2002. For 2001, the overall performance of the economy is weaker than had been anticipated by the group in its 2000 year-end forecast. However, the Committee had indicated that a sharp drop in equity valuations and further increases in oil prices posed downside risks to that forecast.

The Committee expects the Fed to ease interest rates on June 27, and most members look for at least one additional easing in the second half of the year. The group expects inflation to moderate during the rest of 2001 and into 2002 as energy prices recede. The Committee predicts that the unemployment rate will rise in 2001 and again in 2002.

Forecast
The Advisory Committee expects GDP growth for 2001 to average 1.3%, measured from fourth quarter to fourth quarter, the lowest growth rate since 1991.[1] GDP growth is expected to accelerate to 3.5% in 2002, as the economy swings into full recovery. Inflation, as measured by the CPI, is expected to come in at 2.9% for 2001 and is expected to fall to 2.4% in 2002. Most Committee members indicated that they believe energy prices have peaked and will decline over the course of the next year or so. Other members were more cautious and said that the effect of the weak economy on inflationary pressures has not yet been felt. The unemployment rate for 2001 is expected to average 4.6 % and is expected to rise to 5.0 % in 2002. The Committee expects interest rates to remain relatively stable over the course of the next year, although slight increases in short-term rates are anticipated by year-end 2002. The group anticipates that the Federal budget surplus will remain above $200 billion in 2001 and 2002. In the foreign exchange markets, the Committee expects the dollar to weaken slightly against the Japanese yen to 123 yen per dollar

[1] All growth rates are inflation adjusted, and annual comparisons are measured from fourth quarter to fourth quarter. The forecasts discussed in the text and appearing in the accompanying data table are the medians of the individual members' submissions.

The Bond Market Association Economic Advisory Committee Forecast

(Inflation adjusted year-over-year percentage change unless otherwise specified. Forecast numbers appear in **bold**.)

	2000	2001	2002
Real GDP(yr - to - yr)	5.0	**1.5**	**2.8**
Real GDP (4Q - 4Q)	3.4	**1.3**	**3.5**
CPI (yr - to - yr)	3.4	**3.2**	**2.4**
CPI (4Q - 4Q)	3.4	**2.9**	**2.4**
Personal Consumption	5.3	**2.7**	**2.8**
Nonresidential Fixed Investment	12.6	**0.6**	**1.9**
Housing Starts (millions)	1.6	**1.6**	**1.5**
Real State & Local Gov't. Spending	3.5	**2.8**	**2.5**
Merchandise Trade Deficit (billions current $)	449	**443**	**463**
New Home Sales (millions units)	0.9	**0.9**	**0.8**
Existing Home Sales (millions units)	5.0	**5.1**	**4.8**
Unemployment Rate (cal. yr. avg.)	4.0	**4.6**	**5.0**
Federal Budget Surplus (FY, billions of $)	236	**204**	**220**

Quarter-to-Quarter % Changes in Annual Rates

	2001				2002			
	I	II	III	IV	I	II	III	IV
Real GDP	1.3	**0.3**	**1.3**	**2.5**	**3.4**	**3.2**	**3.8**	**3.6**
CPI	4.2	**3.2**	**2.3**	**2.4**	**2.5**	**2.3**	**2.2**	**2.2**
Personal Consumption	2.9	**1.6**	**2.1**	**2.6**	**3.1**	**3.1**	**3.1**	**3.2**
Nonresidential Fixed Investment	2.1	**-6.3**	**-5.0**	**-0.2**	**3.2**	**4.3**	**5.9**	**7.0**

Interest Rates

(monthly average %)

	Sept. 01	Dec. 01	Mar. 02	June 02	Sept. 02
Fed Funds	**3.50**	**3.50**	**3.50**	**3.50**	**3.75**
2 Year Treasury Note	**3.90**	**4.10**	**4.10**	**4.25**	**4.40**
10 Year Treasury Note	**5.20**	**5.28**	**5.50**	**5.60**	**5.63**
30 Year Fixed-Rate Home Mortgages	**7.03**	**7.00**	**7.00**	**7.05**	**6.93**
Municipals (Bond Buyer GO Index)	**5.20**	**5.35**	**5.35**	**5.48**	**5.53**
Moody's Corporate Bond Index (A rated)	**7.70**	**7.70**	**7.50**	**7.50**	**7.50**

Exchange Rates

(monthly average)

	Sept. 01	Dec. 01	Mar. 02	June 02	Sept. 02
Yen/Dollar	**125**	**129**	**125**	**125**	**123**
Dollar/Euro	**.86**	**.87**	**.89**	**.87**	**.91**

by September 2002. The dollar is also expected to weaken vis-à-vis the euro, with the euro reaching $0.91 by the third quarter of next year.

Monetary Policy

The Committee believes that the Fed has been very responsive and has correctly pursued aggressive easing so far this year, but the group is divided as to whether this policy has been effective. The group was unanimous in predicting that the Fed will ease interest rates again at the Federal Open Market Committee meeting on June 27. However, the Committee was evenly divided as to whether the cut will be 25 basis points or 50 basis points. Most of the group expects the Fed will ease again during the second half of the year, but a few believe that another rate cut is unlikely. Most Committee members anticipate that the Fed will not take action in 2002 until the second half of the year.

The Economy

Regarding the current economic weakness, Committee members identified a number of causes such as the overvaluation of stocks in the technology sector, the capital spending slowdown, high energy prices, and excessive monetary policy tightness in 2000. The group was unanimous in their belief that the economy is on the verge of recovery. Most members expect the recovery to begin slowly in the second half of 2001 and expect it will accelerate in 2002. The Committee anticipates that the forthcoming tax cuts will provide some stimulus to the economy in the short-run by lifting consumer spending, but there was disagreement as to the strength of that impact. Most members expect the tax cuts to provide less stimulus in the long-run, partly due to the long phase-in of the tax cuts.

Inflation

The consensus of the Committee is that inflation will moderate during the second half of 2001 and will continue to decline in 2002. Most economists on the Committee believe that energy prices will peak in the near future and will start to fall by the end of this year. However, several members caution that inflationary pressure still remains as the effect of the weak economy and the cyclical loss of productivity gains may put upward pressure on prices.

Credit Conditions

A majority of the group expects credit conditions to continue to deteriorate during the second half of the year, and most believe that the deterioration will be moderate. The Committee cited the investment bust in technology and deterioration in consumer creditworthiness due to rising unemployment as underlying factors. Given the recent tightening of lending standards by banks, most of the Committee expect bond issuance to remain strong due to reduced reliance on the commercial paper market and the desire of corporate borrowers to increase financial liquidity. However, a few members expressed dissenting opinions that bond issuance is likely to slow in the second half of 2001. On the topic of credit quality, most of the Committee anticipate a continued rise in bond default rates, especially in the telecommunications industry and in the high-yield sector.

The Bond Market Association Economic Advisory Committee consists of the following members:

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