THE INFORUM ECONOMIC OUTLOOK: CURRENT PERSPECTIVES ON THE MACROECONOMY

Press Release

December 15, 2008

Economic conditions in late 2008 are grim. The outlook for the next 24 months includes a continuation of the sharp downturn well into 2009, and a very sluggish recovery from the recession. Over the longer term, the current crisis would accelerate a structural shift of the economy from one dominated by growth in consumer spending and residential investment to one paced more by exports, government expenditures, and capital investment. These were some of the conclusions drawn from the Inforum annual economic forecast, which was released December 15, 2008. The headline numbers from the projection are displayed on Table 1 below.

Executive Director of Inforum, Dr. Jeffrey F. Werling, presented the outlook. "Weighing most heavily on the economy, of course, is the unprecedented and protracted financial crisis," said Werling. "Financial institutions are massively "deleveraging," that is, reducing the level of liabilities on their books, which in turn reduces their willingness to lend to businesses and consumers. Even if the banks were ready to grant credit, however, most consumers and many businesses would be reluctant to borrow, as they are deleveraging themselves."

Most responsible for the reluctance to take on debt is the rapid and relentless contraction of housing and equity wealth. Indeed, the economy finds itself in a vicious and dangerous downward spiral of economic confidence that has disrupted both the financial sector and the real economy. The Federal Reserve is guaranteeing an ever-expanding bundle of debt, including credit for non-financial companies and consumers. This unconventional expansion of monetary policy, known as "quantitative easing," has not yet proved to be an effective antidote to financial lock-up.

"The main reason for slow growth ahead is a chastened and fearful American consumer," Werling stated. "Over the past decade consumers have used ever-expanding home equity and stock market wealth as an excuse for overspending and under-saving. Since consumers may be finally convinced that retirement will require more than inflated housing and equity prices, it is unlikely they will return quickly to their spendthrift ways. "In sharp contrast to recent years, private consumption spending is expected to fall by 1.6 percent before rising a relatively anemic 2.1 percent in 2010. Therefore, robust recovery may have to await greater growth in Asia and Europe to spark exports, and this might take awhile."

Especially distressing is the projection for employment. Werling noted that "Some five million jobs may be lost between 2007 and 2009, even with a substantial stimulus package underway. The unemployment rate will rise sharply, but not as much as one might expect because many workers will become discouraged and the labor force will show little increase."

In the meantime, plummeting demand from the private sector has many economists calling for a fiscal stimulus. This stimulus packages should be, in the words of presidential-elect advisor Larry Summers, "significant, speedy and sustained." While the current administration is too lame to introduce such measures, it is clear the incoming Obama administration has the intention and the political capital to enact a significant and sustained stimulus. "We do no yet know the exact formulation of this plan, but apparently it will include large doses both of public infrastructure projects and income transfers, both of which could help ameliorate the recession relatively quickly," said Werling. Our current forecast includes a fiscal stimulus of around $700 billion stretching over 2009 to 2011."

"The stimulus will come not a moment too soon, because we expect GDP contraction to continue through the first part of 2009, and growth in the latter part of the year will be weak. On an annual basis, GDP will fall 1.3 percent and every demand component of GDP will fall except for government expenditure and net exports." Growth in 2010, though positive, will also be subdued, at positive 1.3 percent.

Over the longer term, from 2012 to 2030, growth will be paced by exports and investment and not by consumers as in the past. A renewed fall in the dollar, coupled with recovery abroad, will facilitate the shift from a consumer driven economy to a more balanced one. This future economy will also be characterized by more sober credit utilization and expansion. "New financial regulation and a better accounting for risk will, hopefully, discourage new bubbles from forming in equities, housing, and consumer lending. In this restrained credit environment, and with net exports rising, the current account deficit a percent of national income should fall. The consequent slowing inflow of foreign capital could force government balances towards equilibrium. But in order to both pay for entitlements and to balance the deficit, federal tax rates will have to rise."

ADDITIONAL INFORMATION:
This material was presented at the 2008 Inforum Outlook Conference was held at the University of Maryland on December 9. About 60 professionals from government, private industries, consulting groups, and academia attended the annual event. In addition to summaries of current economic conditions and prospects for the future, the conference featured reports on Inforum's work on health care and energy policy and provided analysis of the recent election results and the new administration's staff and policies. Details, including more information on the current forecast can be found at:
http://www.inforum.umd.edu/organization/conferences/outlook2008/outlook2008.html

Inforum stands for the INterindustry FORecasting at the University of Maryland. Since its founding forty years ago, Inforum has been dedicated to improving business planning, government policy analysis, and the general understanding of the economic environment. For information regarding Inforum's research, contact Jeffrey F. Werling, Executive Director of Inforum and Faculty Research Associate in the University of Maryland's Department of Economics. He may be reached at (301) 405-4607 or werling@econ.umd.edu.

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Table 1
Inforum U.S. Macroeconomic Forecast
December 2008

GDP Account
Real Terms, Annual Percentage Rate of Growth

	06-07	07-08	**08-09**	09-10	10-11	11-15	15-20	20-30
Gross domestic product	2.0	1.4	**-1.3**	1.3	3.0	2.8	2.3	2.3
Personal consumption	2.8	0.3	**-1.6**	2.1	2.0	2.0	2.0	1.8
Nonresidential structures	12.7	13.6	**-5.2**	-12.3	3.2	4.7	0.3	0.9
Equipment investment	1.7	-1.8	**-6.4**	-9.5	5.1	6.6	2.4	3.3
Residential investment	-17.9	-21.1	**-13.2**	3.9	7.2	11.3	3.9	2.9
Exports	8.4	8.1	**-1.6**	3.7	6.7	6.2	4.8	4.5
Imports	2.2	-2.6	**-4.3**	0.6	3.3	3.8	2.7	2.7
Government	2.0	2.8	**2.1**	1.1	1.8	0.8	1.7	1.9
GDP deflator	2.7	2.2	**0.6**	1.4	0.7	2.0	2.6	2.2
Consumption deflator	2.6	2.6	**0.0**	1.8	0.6	2.3	2.8	2.4
Employment	1.1	-1.5	**-1.9**	0.4	0.8	1.0	0.7	0.5

Nominal Values (billions of dollars)

	2007	2008	**2009**	2010	2011	2015	2020	2030
Current account	-701	-677	**-470**	-484	-452	-632	-768	-224
Federal deficit	-280	-474	**-806**	-824	-723	-669	-552	-119