



## *U.S. Forecast - Fall 2008*

### **GDP Outlook**

The U.S. economy will officially be in recession in the second half of 2008. Figure 1 displays model performance for GDP over the past years. Table 1 provides the actual values for GDP from the first half of 2008 and the forecast model predictions for the rest of 2008 and all of 2009 on a quarterly basis. We expect third quarter real gross domestic product (GDP) growth to be revised down to -0.8% from the preliminary reading of -0.3%. In addition, fourth quarter GDP growth will be -2.4%. The decline in GDP reflects broad weakness in the U.S. economy, including the consumer sector. Financial market turmoil makes a significant negative contribution to growth as well. The forecast is for stagnant growth, .5% or less in the first three quarters of 2009, and we cannot rule out continued negative growth in the first and second quarters at this time. Growth is expected to turn positive in the fourth quarter of 2009, somewhat earlier than indicated by Fed minutes and other projections. Longer term growth prospects look good.

*Table 1. GDP, actual and forecasted*

	2008	2009
Quarter 1	0.9%	0.5%
Quarter 2	2.8%	0.4%
Quarter 3	-0.8%	0.5%
Quarter 4	-2.4%	2.2%

### **Industrial Outlook**

The outlook for industrial production and manufacturing is unclear, particularly given the uncertainty surrounding the auto industry. The near term forecast is negative while the longer view shows recovery and growth. Lingering questions regarding the status of the auto industry, the airline industry, the demand for durable goods, the strengthening of the dollar create a wide margin of error around the forecast at this point. As some of our questions and concerns are addressed we will update forecast results accordingly.

### **Unemployment Outlook**

The outlook for unemployment is not good as it is expected to increase further from the current elevated levels by as much as .5% to 1.0%. That would place the unemployment rate at 7.0% to 7.5% in the forecast period. These numbers factor in much of the current financial market crisis and its impact on employment in financial services and related areas. Not factored in are the potential risks of the collapse of one or more of the U.S. automobile manufacturers. Their direct employment numbers are substantial and the affiliated and related employment numbers are large as well. Whether a rescue of the industry occurs and the particular form remain significant outstanding factors for the economic outlook overall, not just for the unemployment rate.

### **Inflation Outlook**

The outlook for inflation is more variable. Figure 2 presents model performance over the last several years of data. Consumer price level increases should diminish from levels experienced earlier this year and for 2009 look to be slightly negative on balance. Producer price levels appear likely to be headed for a strong decline in 2009. Commodity price movements, particularly oil, continue to weigh heavily in these calculations and are undergoing adjustments due to both market supply and demand factors as well as broader financial market readjustment. Our models do not indicate a prolonged or substantial deflationary situation, nor do they indicate a potential stagflation situation with declining output and rising price levels. There will be volatility in prices through much of 2009 with an expectation for low stable inflation returning in early 2010.

**Risks to forecast**

The current forecast does not include any form of proposed stimulus plan nor does it account for any change in financial services sector regulation other than the general deleveraging currently underway. A stimulus plan would likely not be implemented until the second quarter of 2009 and will have temporary effects. Likely it would provide a boost to quarter three numbers and so only bring forward growth from quarter four of next year. Declarations of bankruptcy by auto makers would push down growth numbers and likely lower inflation numbers as well, while clearly pushing up the unemployment rate. We will update the model when solid changes occur.

**Interest Rate Outlook**

The yield curve should strengthen in the next year and beyond displaying a healthy spread between short and long rates. The increased borrowing for financial market rescue efforts outweighs increasing demand for safe investment havens in the current market climate. Despite current suggestions of prolonged deflation we see no large, systemic decline in prices in the future, further pushing up long-term yields. Clearly, the current weakness in the economy and the uncertainty surrounding the outlook require the Fed to keep rates low. However, the Fed will need to be careful about maintaining monetary policy in an accommodating state for too long. Many point fingers at the Fed for keeping rates too low and allowing run-ups in home and other asset prices to occur, contributing to the painful adjustment markets are experiencing currently.

*Figure 1. Actual and predicted gross domestic product.*

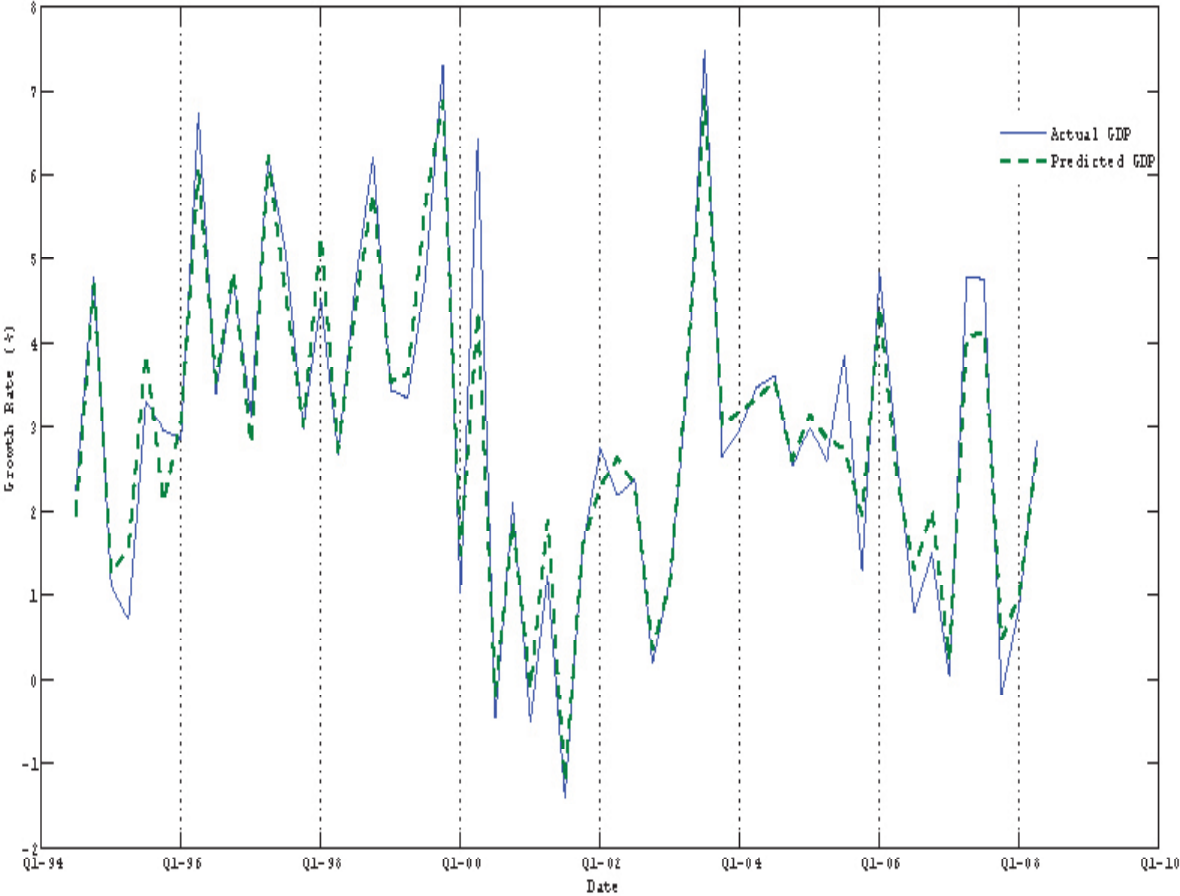
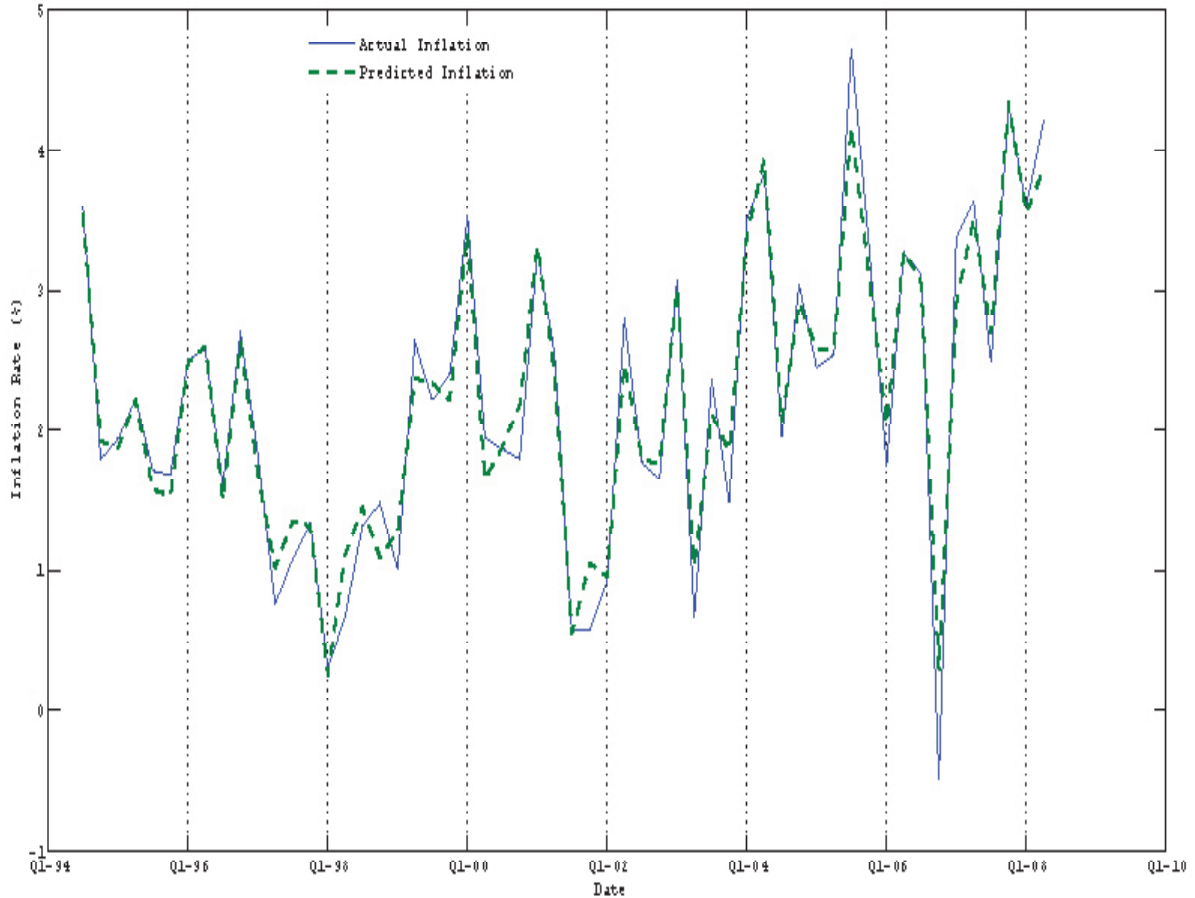


Figure 2. Actual and predicted inflation rates.



---

## *Data Sources*

---

The data employed in the forecasting model are publicly available from a variety of sources. The most comprehensive resource for the macroeconomic variables is the FRED database at the St. Louis Federal Reserve Bank web site ([www.stlouisfed.org](http://www.stlouisfed.org)). Much of the data are available also from the Bureau of Economic Analysis ([www.bea.gov](http://www.bea.gov)) the Bureau of Labor Statistics ([www.bls.gov](http://www.bls.gov)), both of which are an excellent resource for state and local data. If you have suggestions regarding data sources please send them to us.

*David T. Flynn, Ph.D. is Director of the Bureau of Business and Economic Research at the University of North Dakota. Dr. Flynn is also the Clow Banking Fellow and an Associate Professor in the Department of Economics, College of Business & Public Administration. He also serves as the Associate State Director of the North Dakota Small Business Development Center.*

*He can be contacted at:*

*David T. Flynn, Director  
Bureau of Business & Economic Research  
College of Business & Public Administration  
293 Centennial Drive, Stop 8369  
Grand Forks, ND 58202-8369  
Phone: 701.777.3356*

*E-mail: [david.flynn@mail.business.und.edu](mailto:david.flynn@mail.business.und.edu)*

*BBER web site: [www.business.und.edu/bber](http://www.business.und.edu/bber)*

***BBER thanks the following for their support of our forecast report:***

