Economic Forecast - May 19 2008

WASHINGTON (AP) – May 19, 2008 – First the good news: The worst of the painful housing slump and the credit crunch might come to an end this year. Now the bad: The U.S. economy will weaken further and unemployment will rise.

That is the latest outlook from forecasters in a survey to be released Monday by the National Association for Business Economics, also known by its acronym NABE. It will take time for any rays of light to poke through the economic clouds, though.

A growing number of economists believe the U.S. is on the brink of a recession or in one already, dragged down by all the problems in the housing, credit and financial markets. Now 56 percent of the economists think the economy has started or will enter a recession this year. That's up from 45 percent in a survey in February. If there is a recession, it probably will be short and shallow, economists said.

Forecasters downgraded their projections for economic growth. They now predict the economy, which grew by 2.2 percent last year, will slow to 1.4 percent this year. That's lower than the 1.8 percent growth projected in February. If the new figure proves correct, it would mark the weakest growth since the last recession in 2001.

Next year, the economy should grow by 2.3 percent, less than previously forecast and a pace that is still considered subpar.

"Although housing and credit markets will gradually loosen their grip, U.S. economic growth is expected to only slowly return to health," said Ellen Hughes-Cromwick, president of NABE and chief economist at Ford Motor Co.

Given the outlook for sluggish overall economic activity, companies are likely to remain cautious in their spending and hiring.

The unemployment rate, which averaged 4.6 percent last year, will move higher. Forecasters predict the jobless rate will hit 5.3 percent this year and 5.6 percent next year.

Forecasters are hopeful that the housing slump – in terms of home sales – will hit bottom this year. However, economists were divided over whether the low point would be reached in the second, third or fourth quarters of this year. House prices, though, are still expected to drop this year and next.

On the credit front, economists predict conditions will improve in the second half of this year.

"The economy is still going to be weak in the very near term, but the worst is likely to end this year with respect to the housing decline and the credit crunch," said Lynn Reaser, chief economist at Bank of America's Investment Strategies Group, who was involved in the NABE survey. The survey of 52 forecasters was conducted April 17 through May 1.

Weakness in housing was cited as the factor most responsible for the economy's troubles. That was closely followed by credit problems and high energy, food and commodity prices.

With food prices marching upward, gasoline prices closing in on $4 a gallon across the U.S. and oil hitting a record high near $128 a barrel, inflation should rise. Consumer prices will increase 3.6 percent this year, up from a previous forecast of a 3 percent rise. Next year, prices should calm down a bit, with the inflation rate clocking in at 2.4 percent.

To bolster the economy, the Federal Reserve has been cutting a key interest rate since last September. However, when the Fed last lowered rates in April to 2 percent, policymakers signaled that their rate-cutting campaign may be drawing to a close. Fed policymakers are concerned that moving rates lower could aggravate inflation. At the same time, they are hopeful that their powerful rate cuts plus the government's $168 billion stimulus package of tax rebates for people and tax breaks for businesses will lift the country out of its slump.

The forecasters believe the Fed will hold its key rate steady at 2 percent though the rest of this year. However, they predict the Fed will start bumping up rates next year to ward off inflation. They believe the Fed's key rate will rise to 3 percent by the end of 2009.

Economists, meanwhile, had mixed thoughts about the extent to which tax rebates will be spent this year. The more spent, the more energizing effect they will have on the economy. Roughly 35 percent thought households will spend 26 to 50 percent of the rebates, while a quarter believe 25 percent or less would be spent. Thirty-one percent thought 51 to 75 percent would be spent.

"We're likely to see the boost from tax rebates fading later in the year," Reaser predicted. "The recovery is expected to be quite muted."