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Economic Outlook for the Next Twelve Months

Introduction:

This memo provides an economic forecast of the U.S. economy for the coming 12 months, based on historical data and trends of several key economic indicators. The facts will demonstrate that the American economy is performing very well today and that, barring unforeseen events, there is every expectation for continued economic growth -- in excess of 3 percent -- during the next 12 months.

Analysis:

By analyzing the near-term performance of several key economic indicators, such as business investment, new job creation, unemployment rates, production of goods, mortgage rates and new housing starts, the probable performance of the economy over the succeeding few months can be forecast. The data below provide historical details of the economy during the first several months of 2006.

- The United States has experienced 10 straight quarters of rising business investment. This business expansion has led to a substantial increase in employment. In the intervening period, some 4.7 million new jobs have been created and the unemployment rate -- 6.3% in 2003 -- today stands at 4.7%, lower than the average of the 1970s, '80s and '90s.[1]
- The output of goods and services produced by labor and property located in the United States is termed the "Gross Domestic Product" (GDP). During the first quarter of 2006, the GDP increased at an annual rate of 5.3 percent, according to the Bureau of Economic Analysis (BEA). The BEA further reported that goods and services

produced by the labor and property supplied by U.S. residents -- termed the Gross National Product (GNP) -- increased 5.2 percent in the first quarter of 2006. [2]

- A softening housing market is likely to slow the overall pace of growth, but the strength in the business sector will at least partly offset the slowdown. For the past five years, real-estate wealth has supported the economy by providing consumers with disposable income. According to Jan Hatzius, Goldman Sachs's chief U.S. economist, consumers withdrew approximately $887 billion from residential real estate during 2005. He expects that to decline to $552 billion in 2006 and $363 billion in 2007, but states that, "..housing is still a positive."[3]
- With regard to mortgage interest rates, during the period from February 2005 through May 2006, the Federal Reserve increased the Fed Funds rate from 2.5% to 5.02%, causing the Prime Rate to increase from 5.5% to 8.0 %.[4] The concurrent rise in mortgage rates will result in a slowing of home purchases. As home sales start to slow and the inventory of unsold homes climbs, home prices will probably rise more gradually, or even decline, causing consumers to reduce spending. That, in turn, may cause economic growth to slow below the 5+ percent rise of the GDP experienced during the preceding 12-month period.

Conclusion:

The combination of the economic indicators presented in this memo demonstrates that the United States is experiencing an upward trend in the state of the economy, overall, despite the slowdown in the housing market. The consensus forecast of 56 economists surveyed by The Wall Street Journal is that the nation's gross domestic product -- the broadest measure of economic output -- will grow at an annual rate of 3.1% in the second half of 2006.[3] Should that growth rate hold steady, it can be anticipated that the U.S. economy will grow from the GDP reported at the end of the first quarter (Q1) 2006 of $11,394.7 billion to $11,747.9 billion (11,394.7 x 1.031) during the succeeding 12 months, an increase of $353.2 billion. [2]

References

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