NATIONAL ASSOCIATION OF Manufacturers

The Outlook for the U.S. Economy
March 2010

The Current State of the Economy

The December 2007-2009 recession is over. The storm clouds of the longest and deepest recession in the post World War II era have parted.

After falling by 3.7 percent over the course of six quarters, the economy grew in both the third and the fourth quarters of 2009, with the 5.7-percent annualized increase over the last three months of the year the strongest quarterly performance in more than six years.

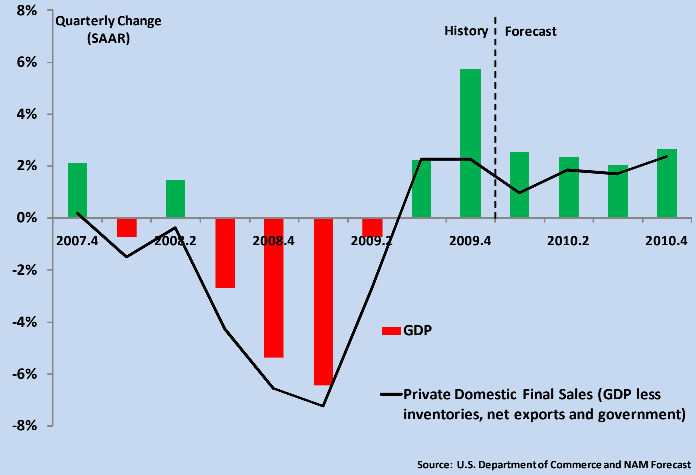
Meanwhile, manufacturing output, after falling by 16 percent over the prior six quarters along with a loss of 2.2 million workers, grew at an annual rate of 7.2 percent in the second half of 2009.

But the economic climate remains overcast. It is important to recognize that a majority of the upturn has been driven by temporary measures, such as a short-term fiscal stimulus and an upturn in business inventories.

For example, encouraged by the "Cash for Clunkers" program as well as the first-time homebuyer tax credit, consumer purchases of motor vehicles and residential investment together accounted for more than half of third-quarter GDP growth.

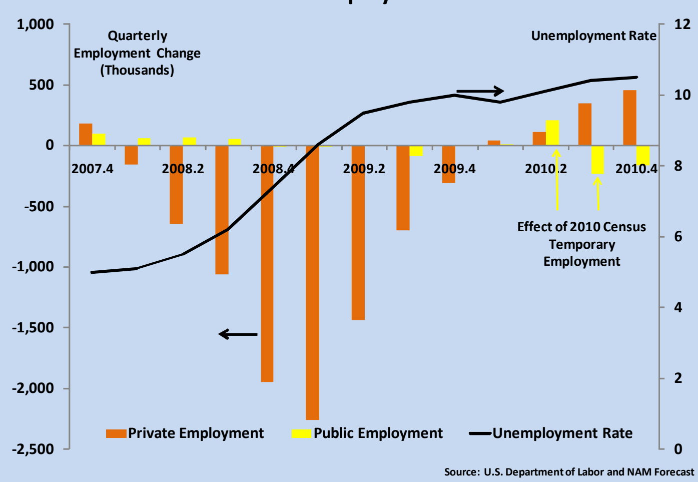
Summary View

Chart 1. The Economic Outlook



The Economic Outlook. The 2007-2009 recession, which was both the longest and the deepest in the post World War II era, is over. However, a strong cyclical rebound, such as those that followed the 1974-1975 and 1981-1982 recessions, is not likely. Despite fiscal and monetary efforts, private domestic final sales (GDP less inventories, net exports and government spending) averaged just 2.3 percent growth in the second half of 2009. This pace is expected to slow early in 2010 before a broad-based expansion begins toward the end of this year (see Chart 1 above).

Chart 2. The Employment Situation



Employment. Though inventory rebuilding and stimulus efforts such as Cash for Clunkers, the first-time homebuyer tax credit and business investment tax provisions have brought the economy out of recession, business sentiment remains cautious, and significant hiring by the private sector is not likely in the near-term. Monthly private sector employment gains are not expected to surpass 150,000 until the fourth quarter, at which time the unemployment rate will likely top out at 10 .5 percent.

In the fourth quarter, expiring investment tax provisions as well as a boost from business inventories accounted for nearly three quarters of the 5.7-percent gain in GDP.

While inventory restocking and the extension of the homebuyer tax credit through mid-2010, in addition to government-financed infrastructure spending, will likely provide some added growth this year, the recovery going forward will be determined more by underlying fundamentals such as an improving labor market, exports and business investment – unless an additional fiscal stimulus is enacted.

The Underlying Fundamentals

⇔ The Labor Market While job losses moderated significantly over the course of 2009, employers have not yet grown confident enough to resume hiring permanent workers. After employment decreased by close to 800,000 last January, employment declines steadily moderated over the past year. In January 2010, employment losses slimmed to just 20,000.

At the same time, the unemployment rate moderated over the past few months to 9.7 percent in January. The fact that temporary employment, which historically has been a precursor to permanent hiring by businesses, has risen on average by 63,000 over the past four months is an encouraging sign.

However, the fact that at least 150,000 net new jobs need to be created per-month to stabilize the labor market signals that the unemployment rate will likely turn higher and not peak until late in the second half of this year. By this time, employment gains should be strong enough to start lowering the unemployment rate. This will likely continue to weigh on consumer confidence in the near term.

⇩ Consumer Confidence While consumer confidence has turned up from a record 42-year low reached last February, it remains 59 percent below its level in July of 2007 and 46 percent below its level in the wake of the terrorist attacks in September 2001.

⇩ Business Confidence Business confidence remains exceptionally fragile. Responses from NAM member companies to the fourth quarter NAM/Industry Week Manufacturing Index showed that more than half (52 percent) of survey respondents do not expect an upturn in their company's production to take place until the second half of 2010 at the earliest. The survey also showed that 40 percent of respondents continue to have a negative business outlook.

At the same time, the January report by the National Federation of Independent Businesses (NFIB) showed that while small companies' outlook has improved from early 2009, it is just barely positive and is more guarded than it was during much of the second half of last year.

Policy uncertainty is weighing on the collective business psyche. How health care reform, energy policy, regulatory reform and tax policy play out this year are collectively creating enormous concerns for the global competitiveness of U.S. companies, especially manufacturers.

⇔ Credit Conditions While certainly better than a year ago, commercial banks' willingness to lend remains guarded. According to the Federal Reserve's first quarter Senior Loan Officer

Opinion Survey, banks continue to tighten lending standards on small and medium commercial loans.

At the same time, the first-quarter survey showed that while demand by businesses for loans has improved, it still remains very low -- evidence that businesses remain very cautious in their spending plans. This is supported by the most recent NAM/Industry Week Manufacturing Index, which showed that companies expect their capital investment expenditures to edge down 0.8 percent over the coming year.

⇔ Monetary Policy and Inflation The Federal Reserve is not expected to raise interest rates until late this year, since any premature tightening could jeopardize the recovery, and inflation remains contained.

Given the slack labor market, which suppressed the growth in private-sector hourly earnings to just 2.5 percent over the past year (well below the 3.9 annual average during the 2006-2008 period), overall inflation concerns remain muted. During the 12 months ending in January 2010, consumer prices rose a moderate 2.6 percent while core inflation, which excludes energy and food products, edged up less than 1.5 percent.

⇔ Energy Prices Over the past three years, oil prices peaked as high as nearly $150 a barrel in the summer of 2008 and fell well below $50 a barrel at the start of 2009. Currently just under $75 a barrel, oil prices are expected to trend modestly higher as the global recovery gains steam and to remain near $80 a barrel in 2010. Natural gas prices will have trouble keeping up. Abstracting from weather-related events, demand has weakened from the recession and supply has increased significantly in response to previous high prices. Currently just above $6 per thousand cubic feet, natural gas prices will likely remain near this level this year but will trend higher once domestic demand accelerates.

⇧ Trade The one unqualified positive fundamental to develop over the past year has been on the trade front. The global economy, led by Asia and South America and to a lesser extend Europe, has rebounded. At the same time, the value of the dollar as of February is about 8 percent below its long-term average. This combination is fueling a strong export recovery that should continue into 2010.

In stark contrast to the early stages of the last recovery (2002 and early 2003), when export growth was burdened by an overvalued dollar and weak demand abroad, exports were the fastest-growing final demand component of the U.S. economy in the second half of last year:

Average Annual Growth Rate (2nd Half 2009)	
GDP	4.0 percent
Consumer Spending	2.4 percent
Business Investment	-1.6 percent
Residential Investment	12.1 percent
Exports	17.9 percent
(Goods Exports)	***26.4 percent***
Government Spending	1.2 percent

While such strong growth will not likely continue throughout 2010, the global fundamentals are shaping up very well for U.S. exports for 2010. In fact, exports are expected to account for over 40 percent of U.S. GDP growth this year. As detailed in the next section, this is due to two factors: (1) solid export growth and (2) a deceleration in other areas of the economy, especially in the first half of the year.

The Economic Outlook

Consumer Spending After increasing at an annual rate of 2.8 percent in the third quarter, largely from a 44-percent gain in motor vehicle purchases encouraged by the Cash for Clunkers program, consumer spending slowed to 2-percent growth in the fourth quarter.

Going forward, a stagnant labor market, sluggish wage growth and weak consumer confidence will collectively conspire to further decelerate consumer spending over the next few quarters.

The current forecast expects consumer spending to increase at an average annual rate of just 1.2 percent through the first three quarters of 2010. Then, as the labor market begins to recover, consumer spending will gradually accelerate to 1.5-percent growth in the fourth quarter and a stronger 3.4 percent during the first half of 2011.

Business Investment Investment spending by businesses is expected to be positive, but restrained, in 2010.

Business expenditures on capital investment rose an annual rate of 2.9 percent in the fourth quarter of 2009, largely due to the expiration of a bonus depreciation tax credit. The resulting 13.3-percent increase in equipment and software spending, which was the fastest quarterly pace since the first quarter of 2006, will not be repeated in coming quarters.

After decelerating to 1.7-percent growth in the first quarter, business investment spending is expected to rise by a moderate pace of 3.7 percent in the second and third quarters of this year before businesses become more confident that a self-sustaining recovery has emerged.

Afterward, firms will begin to slowly accelerate investment plans toward the end of 2010 and into next year. Note: the outcomes of policy debates in areas such as health care and climate change could have a significant impact on firms' investment plans.

The current outlook forecasts business investment to rise by a modest 3.6 percent in 2010 and then accelerate to 7.4-percent growth in 2011.

Housing After moderating early in the fourth quarter, building permits and housing starts trended upward in recent months, as did the National Association of Homebuilders overall housing market index. Together, these measures signal that a recovery in the housing market is continuing, but the pace will likely be lackluster.

This expectation of a modest upturn is supported by the most recent (January 2010) Federal Reserve Board Senior Loan Officer Survey on Bank Lending Practices, which showed that while the net percentage of banks tightening standards on traditional mortgages moderated significantly over the past year, the share reporting stronger demand, while up significantly from a year ago, remains subdued.

After increasing at a 12-percent pace in the second half of 2009, driven in part by the introduction of the first-time homebuyer tax credit, residential investment is expected to grow at a more modest 5-percent pace in the first half of the year before a strong recovery starts to accelerate in the second half of the year and into 2011.

International Trade In 2010, the dollar is expected to remain fairly stable, falling another half a percent as a gradually improving U.S. economy begins to catch up with recoveries abroad. This, along with improving global conditions, will support very solid export growth in 2010. After falling by just 1.7 percent last year due to large decreases in the first half of the year being nearly balanced by strong growth in the second half of the year, exports are expected to increase by 8.7 percent this year, accelerating to 12.2-percent growth in 2011.

With domestic demand increasing at a slower pace than overseas economies, imports will rise by a more moderate 5.7-percent pace this year, followed by a stronger 7.6-percent rise in 2011 as broad-based U.S. expansion gains traction.

The trade deficit is expected to narrow to 2.5 percent of GDP by 2011, the smallest deficit as a share of GDP since 1998. Further narrowing of the trade balance could take place in subsequent years. However, this will likely be determined not only on the health of the global economy but by policies enacted in Washington D.C.

On the positive side, lowering barriers abroad by passing a number of free trade agreements awaiting congressional approval would increase U.S. companies' access to foreign markets. On the negative side, probable cost increases on U.S. companies associated with current health care reform proposals as well as current climate change proposals would reduce U.S. competitiveness and cut into export growth while increasing import competition.

Outlook for GDP and Manufacturing Production

GDP With consumer spending and business investment remaining tepid in the near term, the overall economy will decelerate to 2.5-percent growth in the first half of 2010.

However, excluding additional gains in inventories, which will likely be aided by an upturn in the manufacturing sector, international trade and government spending, private domestic final sales (consumer spending, business fixed investment and housing) are expected to increase at an annual rate of just 1.4 percent in the first half of the year, which is a deceleration from the 2.3-percent growth attained in the second half of last year.

As the labor market begins to improve in the second half of the year, more solid growth in consumer spending and business investment will join upturns in housing and exports, and a self-sustaining recovery should finally begin to emerge toward the end of the year and then accelerate in 2011.

After increasing by a slightly more solid 2-percent annualized pace in the second half of the year, private domestic final sales should increase to 4.3-percent growth in the first half of 2011 as a broad-based domestic recovery finally beings to take hold.

After edging up just 0.1 percent in 2009, the U.S. economy is expected to increase by a modest 2.4 percent in 2010 before accelerating to 4.6-percent growth in 2011.

Manufacturing Production After declining by 8.6 percent in 2008 and 4.6 percent in 2009, moderate upturns in domestic final sales this year as well as solid export growth and inventory restocking are expected increase manufacturing production by 2.9 percent in 2010, the first time since 2005 that the manufacturing sector will outpace the overall economy, with roughly half of the increase in factory output this year being driven by exports.

As the domestic economy gains traction in 2011, manufacturing production should accelerate to 4.4-percent growth in 2011, which would be the fastest yearly increase since 1999.

Employment Expectations

After falling by 8.4 million from December 2007 to January 2010, current trends suggest that the economy will start to increase employment at a very gradual pace in 2010.

In the first quarter of 2010, overall non-farm payroll employment is expected to increase by 54,000, as continued increases in temporary workers as well as gains in education and health services, which have been largely immune from the recession, more than offset moderate employment declines in other sectors such as manufacturing, trade, transportation, utilities, information, finance and natural resources.

In the second quarter, employment is expected to increase by a significant 317,000. However, more than 80 percent of this increase will be in federal government employment, as the Commerce Department hires temporary workers to conduct the 2010 Census. Gains in private sector employment will again mainly be in temporary employment and education and health services.

Not until the second half of the year will employment in most private sectors start to expand. Private payrolls are anticipated to increase by 348,000 (an implied 116,000 monthly gain) in the third quarter and 454,000 (151,000 monthly gain) in the fourth quarter.

With a broad-based expansion expected to deliver strong growth in 2011, private employment growth should reach 550,000 in the first quarter of 2011 and 760,000 in the second quarter of next year.

Within manufacturing, factory employment is expected to increase by 92,000 from the third quarter of 2010 to the second quarter of 2011.

With monthly employment gains not expected to exceed 150,000 until the fourth quarter of this year, the unemployment rate (currently at 9.7 percent in January) is expected to edge up modestly and peak at 10.5 percent in the fourth quarter, after which time stronger job gains will begin to reduce the jobless rate. By the end of next year, the unemployment rate will stand at 8.7 percent, still high by historic standards.

David Huether, NAM Chief Economist

The NAM Economic Outlook, March 2010

GDP annualized (% change, SAAR)

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	Q4/Q4 (% change) 2009	2010	2011
Gross Domestic Product	-6.4	-0.7	2.2	5.7	2.6	2.4	2.0	2.6	3.5	4.7	0.1	2.4	4.6
Private Domestic Final Sales*	-7.3	-2.7	2.3	2.3	1.0	1.8	1.7	2.3	3.6	5.0	-1.4	1.7	5.1
Manufacturing Production	-21.7	-8.1	9.0	5.5	2.5	1.2	4.0	3.9	4.3	3.9	-4.6	2.9	4.4
Consumption													
Total	0.6	-0.9	2.8	2.0	1.1	1.3	1.1	1.5	2.9	4.0	1.1	1.3	4.0
Durable Goods	3.9	-5.6	20.4	-0.9	-2.4	2.4	0.7	2.1	3.1	5.9	4.5	0.7	5.9
Nondurable Goods	1.9	-1.9	1.5	4.3	1.5	1.3	1.5	1.8	2.4	3.0	1.4	1.5	3.0
Services	-0.3	0.2	0.8	1.7	1.6	1.1	1.1	1.3	3.0	4.0	0.6	1.3	4.0
Investment													
Total Fixed	-39.0	-12.5	-1.3	3.5	1.4	5.0	5.1	7.1	8.0	10.2	-12.3	4.7	10.8
Nonresidential	-39.2	-9.6	-5.9	2.9	1.7	3.6	3.8	5.2	5.1	7.4	-12.9	3.6	7.4
Structures	-43.6	-17.3	-18.4	-15.4	-7.1	1.3	2.3	4.8	7.0	11.7	-23.7	0.3	11.7
Equipment & Software	-36.4	-4.9	1.5	13.3	5.4	4.6	4.4	5.5	4.5	5.8	-6.6	5.0	5.8
Residential	-38.2	-23.2	18.9	5.7	0.3	9.8	9.8	13.7	17.9	19.6	-9.2	8.4	22.2
Imports & Exports													
Net exports*	-386.5	-330.4	-357.4	-341.1	-341.4	-339.4	-327.6	-315.3	-303.1	-288.3	-353.9	-330.9	-282.8
Exports	-30.0	-4.1	17.8	18.1	7.6	8.4	9.1	9.7	10.5	11.6	0.5	8.7	12.2
Imports	-36.4	-14.8	21.3	10.5	6.2	6.4	5.0	5.4	6.2	6.7	-4.8	5.7	7.6
Government													
Total	-2.6	6.7	2.7	-0.2	0.6	1.1	1.2	1.4	1.0	0.8	1.6	1.1	0.7
Federal	-4.2	11.4	7.9	0.1	1.9	2.9	2.2	2.6	2.2	1.5	3.8	2.4	1.1
State & Local	-1.6	3.9	-0.6	-0.3	-0.2	-0.2	0.5	0.6	0.3	0.3	0.3	0.2	0.4

* GDP less inventories change, net exports and government spending
** Billions 2005 dollars

Labor Market (quarterly change in thousands)

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	Q4/Q4 (thousands change) 2009	2010	2011
Total nonfarm payroll employment	-2,210	-1,720	-1,010	-450	50	320	110	300	560	820	-5,390	780	3,280
Total Private	-2,220	-1,750	-920	-450	50	110	350	450	550	760	-5,340	960	2,990
Manufacturing	-600	-460	-230	-140	-50	-30	0	20	20	50	-1,430	-60	170
Unemployment Rate	8.2	9.3	9.6	10.0	9.8	10.2	10.4	10.5	10.3	9.9	9.3	10.2	9.5

Source: U.S. Departments of Commerce and Labor and NAM forecast based on Economy.com's Macro Model