U.S. Economic Outlook

CONNING

March 2010

We expect restrained GDP growth into at least mid-2010.

Though U.S. GDP growth reached a remarkably high 5.9% clip in the fourth quarter of last year, the surge incorporated a heavy skewing of growth toward inventories. Early reports for Q1 have undershot expectations and have put forecasts of growth on the defensive. We indeed were surprised at the concentration of the inventory rebound in Q4, but even with a lull in growth as we enter 2010, the figures, in our view, remain on track with a restrained but positive expansion through 2010 and beyond. We continue to see sluggish growth in final sales since the start of expansion in July of 2009, with 1.5% growth in Q3, 1.9% growth in Q4, and an estimated 0.5% growth in Q1 of this year, as indicative of restrained but positive GDP growth into at least mid-2010. Prospects for growth in final sales continue to hinge on the willingness of business to reverse the sizable 2009 drop in investment spending in the face of sluggish consumption.

Fed Chairman Bernanke believes the U.S. is in a “nascent” recovery.

At the semi-annual testimony before Congress, Fed Chairman Bernanke said that the U.S. is in a “nascent” recovery and still requires low interest rates to encourage demand by consumers and businesses when the federal stimulus expires. Slack labor markets and low inflation will allow the FOMC to keep the federal-funds rate “exceptionally low for an extended period.”

Fewer jobs lost in February, but the economic recovery is not yet strong enough to generate employment gains.

According to the Labor Department, 36,000 jobs were lost in the month of February—less than the 68,000 loss of jobs forecasted by economists. The unemployment rate remained constant month-over-month (m-o-m) at 9.7%. Payrolls for January were adjusted downward to a loss of 26,000 jobs from the initial report of down 20,000 jobs. While the U.S. has begun to lose jobs at a slower rate, the economic recovery, which began in the third quarter of 2009, has not been strong enough to generate gains in employment.

Jobs increased in the service sector in February.

The Labor Department report showed that government payrolls decreased by 18,000, partially offset by the hiring of 7,000 workers, some of whom were hired for census work. State and local governments reduced employment by 25,000 during February. Factory payrolls rose by 1,000, payrolls at builders fell 64,000 and financial firms lost 10,000 jobs. Service industries added 24,000 workers. Retail payrolls were little changed m-o-m. The number of temporary workers increased by 48,000 for the month.

Core CPI month-over-month fell for the first time since 1982.

Consumer prices rose less than expected in January. The all-items CPI showed an increase of 2.6% year-over-year (y-o-y) versus an expected increase of 2.8%. The core CPI increased by 1.6% y-o-y versus an expected increase of 1.8%. The core CPI m-o-m reading fell by 0.1%, falling for the first time since 1982. Low inflation will allow the Fed to keep rates low to support a recovery.

We believe downside risks in this cycle will switch to inflation concern by 2011.

We believe downside economic risks in this cycle will switch to inflation concern by 2011 and beyond. The speed of transition to an exit strategy at the Fed will dictate the inflation path. We expect bond yields to climb in 2010 and 2011 with massive new supply, a diminished flight-to-quality premium, a falling dollar and an expanding global economy that should keep a bid on commodity prices. By 2011, we expect $85-a-barrel oil and a 4.5% 10-year Treasury yield, with restrained equity market gains.

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U.S. Forecast Summary

	Actual →				Forecast →					Actual	Forecast →		
KEY ECONOMIC INDICATORS	**1Q09**	**2Q09**	**3Q09**	**4Q09**	**1Q10**	**2Q10**	**3Q10**	**4Q10**	**1Q11**	**2009**	**2010**	**2011**	**2012**
Gross Domestic Product	-6.4%	-0.7%	2.2%	5.9%	2.6%	2.6%	2.8%	3.0%	3.5%	-2.4%	3.0%	3.4%	3.9%
Change in Inventory (2000$,bln)	-$76.5	-$46.3	$21.0	$122.3	$73.8	$39.2	-$8.3	-$32.6	$4.4	-$81.7	$181.6	-$7.9	$26.4
Civilian Unemployment Rate	8.2%	9.3%	9.7%	10.0%	9.8%	9.9%	10.1%	10.0%	9.8%	9.3%	9.9%	9.3%	8.2%
Capacity Utilization	70.4%	68.7%	70.0%	71.4%	72.8%	73.8%	74.7%	75.6%	76.5%	70.1%	74.3%	77.8%	80.5%
ISM Index	35.9	43.0	51.4	54.6	57.0	55.8	55.1	55.0	55.0	46.2	55.7	55.0	55.0
ISM Non-Manufacturing Index	42.2	44.9	48.3	49.4	51.0	51.8	53.2	53.8	54.7	46.2	52.5	55.2	55.5
Retail Sales	-5.5%	-1.4%	6.4%	7.6%	5.1%	6.1%	5.4%	5.5%	5.7%	-6.0%	5.6%	5.6%	5.4%
Michigan Consumer Sentiment	58.3	68.2	68.4	70.2	73.7	75.0	77.5	79.2	81.5	66.3	76.4	84.3	88.6
Total Vehicle Sales (mln units)	9.7	9.8	11.7	11.1	11.0	11.7	12.1	12.5	12.8	10.5	11.8	13.5	15.3
Housing Permits (millions)	0.531	0.529	0.573	0.598	0.617	0.627	0.657	0.700	0.745	0.558	0.650	0.840	1.123
New Home Sales (millions)	0.338	0.372	0.406	0.370	0.313	0.337	0.345	0.360	0.377	0.372	0.339	0.425	0.557
Existing Home Sales (millions)	4.610	4.780	5.280	5.970	5.183	5.333	5.425	5.500	5.575	5.160	5.360	5.688	5.988
S&P Case-Shiller C-20 (Y/Y)	-19.0%	-14.7%	-8.7%	-2.5%	4.2%	0.9%	-1.5%	0.9%	3.8%	-11.5%	1.1%	5.1%	6.2%
WTI Oil Price	$42.96	$59.54	$68.20	$76.07	$77.93	$85.50	$86.55	$83.23	$86.65	$61.69	$83.30	$92.06	$102.12
CPI	-2.2%	1.9%	3.7%	2.6%	1.9%	1.6%	1.5%	1.5%	1.8%	-0.3%	2.1%	1.8%	2.2%
CPI (Y/Y)	0.0%	-1.2%	-1.6%	1.4%	2.5%	2.4%	1.9%	1.6%	1.6%	2.7%	1.6%	2.0%	2.2%
CPI Core (Y/Y)	1.8%	1.8%	1.4%	1.7%	1.5%	1.2%	1.3%	1.2%	1.6%	1.8%	1.2%	1.8%	2.1%
PPI	-5.5%	2.5%	3.2%	7.0%	8.4%	1.3%	2.7%	2.8%	2.8%	-2.5%	4.7%	2.7%	2.8%
PPI (Y/Y)	-1.9%	-4.3%	-5.4%	1.6%	4.9%	4.6%	4.4%	3.4%	2.0%	4.4%	2.8%	2.4%	2.4%
Fed Funds Rate	0.16%	0.22%	0.07%	0.05%	0.13%	0.13%	0.25%	0.50%	1.00%	0.16%	0.20%	1.58%	3.65%
2-Year Note Yield	0.81%	1.11%	0.95%	1.14%	1.05%	1.20%	1.50%	1.75%	2.10%	0.95%	1.29%	2.58%	4.11%
10-Year Note Yield	2.71%	3.53%	3.31%	3.85%	3.80%	3.95%	4.10%	4.25%	4.40%	3.29%	3.97%	4.58%	5.15%

Source: Action Economics