

We expect a slow but positive growth trajectory, despite the global markets recent pessimistic turn on the economy.

Global markets have turned more pessimistic on the economy in recent weeks, though we see these disappointments as mostly reversing the excessive optimism in April and May. We have trimmed our U.S. growth forecasts only modestly for 2010 to leave what we would still describe as a slow but positive growth trajectory for an expansion that began in July of last year. U.S. GDP should post growth of 3.3% in Q2 following the 2.7% Q1 clip, and we continue to expect GDP growth of 3%-4% in Q3 and beyond. Final sales grew at real rates of only 0.7%-1.7% in each of the four quarters ending in Q1, though we expect 2% growth in Q2, and 3%-4% into 2011.

Housing activity remains restrained.

Market psychology has been hit by the expected post-April downturn in the U.S. housing sector, though this was clearly driven by the home-buyers tax credit distortion, and we still see housing as recovering from a bottom in Q1 of 2009. Beyond this, the trajectory for business fixed investment remains subpar thanks to the weak commercial construction sector, which should continue to restrain growth.

The Fed reiterated its pledge to keep interest rates near zero.

At their June meeting, Fed policy makers left the federal-funds rates unchanged in a range of zero to 0.25%. A lack of signs of inflation, concern over unemployment and housing were among the reasons the Fed reiterated their pledge to keep interest rates near zero for an "extended period."

The unemployment rate declined in June, though the hiring rate remains sluggish.

Non-farm payrolls declined by 125,000 last month as the government cut 225,000 temporary census workers. Payrolls in the private sector increased by 81,000 jobs. The unemployment rate fell to 9.5% from 9.7%, as discouraged unemployed workers stopped seeking employment. At the current pace of hiring, it could take years for the U.S. economy to recover the eight million jobs lost during the last recession.

May's monthly decline was the biggest since December 2008.

The May all-items CPI fell for the second consecutive month. The 0.2% decline in May's CPI reading followed April's drop of 0.1%. May's monthly decline was the biggest since December 2008. The latest cost of living report signals that the economy is recovering without rising inflation.

The Fed's transition to an exit strategy has been delayed by market turmoil.

The Fed's gradual transition to an exit strategy clearly has been delayed by the re-emergence of market turmoil, though we do expect this focus to return to the Fed and the markets by early 2011. We believe the Fed will resume its transition to a more hawkish rhetorical posture with rate hikes by Q2 of next year. The flight to quality into the U.S. Treasury markets has depressed yields, though we expect this drop to be reversed later this summer, with a resumed cyclical climb in rates through Q4 and on into 2011 and 2012.

U.S. Forecast Summary

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KEY ECONOMIC INDICATORS	Actual →				Forecast →						Actual →			
	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	2009	2010	2011	2012
Gross Domestic Product	-0.7%	2.2%	5.6%	2.7%	3.3%	3.2%	3.5%	3.8%	4.0%	4.1%	-2.4%	3.2%	3.7%	4.1%
Change in Inventory (2000\$,bln)	-\$46.3	\$21.0	\$119.5	\$60.9	\$38.4	\$9.1	-\$13.3	\$3.4	\$20.0	-\$13.0	-\$82.4	\$179.5	\$12.0	-\$22.4
Civilian Unemployment Rate	9.3%	9.7%	10.0%	9.7%	9.7%	9.6%	9.7%	9.5%	9.3%	9.0%	9.3%	9.7%	9.2%	8.0%
Capacity Utilization	68.5%	69.9%	71.1%	72.5%	73.6%	74.2%	74.9%	75.7%	76.4%	77.0%	70.0%	73.8%	76.6%	78.3%
ISM Index	43.0	51.4	54.6	58.2	58.8	56.5	56.5	55.9	55.2	55.0	46.2	57.5	55.3	55.0
ISM Non-Manufacturing Index	44.9	48.3	49.4	53.0	55.4	56.3	57.2	57.5	57.0	56.5	46.2	55.5	56.9	56.5
Retail Sales	-0.2%	7.3%	7.5%	8.2%	5.1%	-1.2%	5.3%	5.8%	5.5%	6.1%	-6.3%	5.4%	4.8%	6.0%
Michigan Consumer Sentiment	68.2	68.4	70.2	73.9	73.9	75.5	77.1	79.2	81.4	83.0	66.3	75.1	82.1	86.3
Total Vehicle Sales (mln units)	9.8	11.7	11.1	11.2	11.5	11.6	12.0	12.4	12.8	13.3	10.5	11.6	13.1	15.0
Housing Permits (millions)	0.558	0.601	0.626	0.655	0.595	0.630	0.668	0.700	0.759	0.832	0.583	0.637	0.798	1.053
New Home Sales (millions)	0.368	0.401	0.373	0.362	0.355	0.339	0.365	0.386	0.407	0.428	0.374	0.355	0.419	0.536
Existing Home Sales (millions)	4.780	5.280	5.970	5.140	5.483	4.833	5.200	5.350	5.425	5.500	5.160	5.164	5.463	5.763
S&P Case-Shiller C-20 (Y/Y)	-14.6%	-8.5%	-2.3%	2.0%	-0.9%	-3.8%	-2.3%	1.6%	1.7%	1.7%	-11.4%	-1.3%	1.8%	3.9%
WTI Oil Price	\$59.54	\$68.20	\$76.07	\$78.63	\$78.52	\$76.47	\$78.50	\$82.97	\$92.53	\$95.62	\$61.69	\$78.03	\$91.60	\$111.61
CPI	1.9%	3.7%	2.6%	1.5%	-0.6%	0.3%	2.1%	2.0%	1.9%	2.2%	-0.3%	1.5%	1.6%	2.3%
CPI (Y/Y)	-1.2%	-1.6%	1.4%	2.4%	1.8%	1.0%	0.9%	1.0%	1.6%	2.1%	2.7%	0.9%	2.2%	2.5%
CPI Core (Y/Y)	1.8%	1.4%	1.7%	1.3%	0.9%	1.0%	0.9%	1.2%	1.2%	1.2%	1.8%	0.9%	1.4%	2.0%
PPI	2.5%	3.2%	6.2%	8.9%	-0.1%	0.9%	3.3%	3.2%	2.9%	2.9%	-2.5%	4.2%	2.6%	3.2%
PPI (Y/Y)	-4.3%	-5.4%	1.4%	4.9%	4.6%	4.1%	3.3%	2.0%	2.7%	3.2%	4.3%	2.8%	3.2%	3.4%
Fed Funds Rate	0.22%	0.07%	0.05%	0.09%	0.18%	0.18%	0.18%	0.25%	1.00%	1.50%	0.16%	0.17%	1.01%	3.44%
2-Year Note Yield	1.11%	0.95%	1.14%	1.02%	0.70%	0.95%	1.10%	1.60%	2.10%	2.50%	0.95%	0.90%	2.15%	3.90%
10-Year Note Yield	3.53%	3.31%	3.85%	3.84%	3.00%	3.30%	3.60%	3.90%	4.20%	4.35%	3.29%	3.43%	4.15%	4.66%
EUR-USD	1.36	1.43	1.48	1.38	1.28	1.22	1.22	1.23	1.24	1.25	1.39	1.28	1.25	1.28
USD-YEN	97.4	93.5	89.9	90.7	92.1	90.5	89.8	89.2	88.5	87.8	93.6	90.8	88.1	86.2
USD-CAD	1.17	1.10	1.06	1.04	1.03	1.05	1.04	1.03	1.03	1.02	1.14	1.04	1.02	1.00

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