

ECONOMIC FORECASTING SURVEY

Economists Brighten Views, Praise Fed in Latest Survey

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The Federal Reserve may have stopped the economic bleeding caused by a summer credit crunch, the latest WSJ.com forecasting survey suggests, as economists turned more optimistic in the last month.

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The survey, conducted Oct. 5 through Oct. 9, showed the average forecast for chance of recession moved lower to 34%. That was the first decrease since June and followed a forecast of a 36% probability of recession in the September survey. Expectations for payrolls growth and corporate profits were also up for the first time in the second half of the year. Meanwhile, most forecasts for gross domestic product either stayed the same or moved higher following four consecutive downward revisions. Only the fourth-quarter expectations were slightly lowered -- by 0.1 percentage point to 1.8% growth.

The economists overwhelmingly approved of the Fed's decision on Sept. 18 to cut the target for the federal-funds rate by a larger-than-expected half percentage point. Seventy-six percent said the move was appropriate, compared with just 22% who thought it was too aggressive. Just one economist felt that the cut wasn't aggressive enough. That contrasts with a recent, but unscientific, WSJ.com reader poll in which 60% of respondents said the Fed action too aggressive.

"Some of the uncertainties have faded, partly due to the fact that the Fed moved more aggressively," said Lou Crandall, chief economist at Wrightson ICAP. "The Fed's willingness to pull out all the stops played a role in bolstering the economy."

Indeed, confidence in the central bank was reflected in the economists' average grade for Ben Bernanke. In the wake of the interest-rate cut, the Fed chairman scored 90 out of 100, the highest mark he has received in the survey since his tenure began.

ABOUT THE SURVEY

The Wall Street Journal surveys a group of 60 economists throughout the year. Broad surveys on more than 10 major economic indicators are conducted semiannually, at midyear and at year-end. Between each semiannual survey, four monthly updates are conducted for the most closely watched forecasts. For prior installments of the semiannual and monthly surveys, see: WSJ.com/Economists.

European Central Bank President Jean-Claude Trichet, who was the first to respond to the credit crisis by injecting liquidity into markets in August after BNP Paribas froze three of its asset-backed securities funds, also received a score of 90. Meanwhile, Bank of England Governor Mervyn King didn't fare quite so well, scoring a 78 with the economists. Mr. King largely stood on the sidelines while the Fed and ECB were pumping liquidity into markets, only stepping in following a bank run on Northern Rock PLC triggered by the midsize U.K. lender's credit problems.

Scott Anderson of Wells Fargo & Co. singled out Mr. Bernanke, saying his "response to financial and economic risks has been closest to the mark."

The economists seem to think the Fed still has more work ahead. On average, they expect the federal-funds rate to be reduced one more time this year, by a quarter-percentage point, with 30 of 54 respondents forecasting 4.5% as the year-end rate. Not one of the economists sees an increase this year. However, the first half of 2008 isn't quite as clear. The average forecast is for 4.5% with 21 economists choosing that level, but 20 economists expect it will be lower and 13 see it higher.

But the Fed isn't without its critics. "I don't think the economy is necessarily in need of a lower fed-funds rate," said Stephen Gallagher of Societe Generale. "It's not a huge mistake, but maybe they did it too soon. The drag [from housing and the credit crunch] is going to deepen more than diminish. The Fed can't really avoid that."

The economists still paint a bleak picture of the housing market. They marked down their projections for housing starts in both 2007 and 2008 for the fourth consecutive time. Meanwhile, home prices as measured by the Office of Federal Housing Enterprise Oversight housing price index, which has never registered a year-to-year decline, are seen by economists as declining 1.26% in 2007 and 2.55% in 2008, down from previous estimates of 1.16% and 2.25% falls, respectively.

"The risks not gone," said Mr. Crandall of Wrightson ICAP. However, "we've gotten through much of that particular episode."

Among other findings of the survey:

- Economists take issue with projections by former Fed Chairman Alan Greenspan in his memoir "The Age of Turbulence." When asked to characterize Mr. Greenspan's expectations of average 4% to 5% inflation between now and 2030, 84% of respondents said it was too high, while just 14% judged it about right. Similarly, 77% said the ex-

chairman's forecast of U.S. Treasury yields at 8% or higher during the same period was too high, while 23% said it was about right.

- A majority of the economists, some 61%, said the portfolio limits of Fannie Mae and Freddie Mac should be increased, but 19 of the 29 who favored the rise said it should only be temporary.
- Forecasts for the price of crude oil were again moved higher. On average, the economists see the cost at \$72.57 by year-end and \$68.58 by next June. However, both projections are well below the current price of over \$80 a barrel.

Courtesy of JB Goodwin