

Forecasting *the* U.S. Economy

Goldman Sachs's Jan Hatzius saw the recession coming a year before it was officially declared. His expectations on GDP, joblessness and the fed funds rate make him the top economist for 2008 to 2009. **By BOB WILLIS**

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HEN FORECASTERS look back at the chain of disasters that brought down the U.S. economy during the past two years, one indicator stands out: employment. Jan Hatzius, chief U.S. economist at Goldman Sachs Group Inc., says a January 2008 government employment report told him that the housing downturn then plaguing the country had broadened out to a full-blown recession, pushing joblessness up to 5 percent in December 2007 from 4.7 percent the prior month.

Top Economists

Accuracy score¹

1	Jan Hatzius , Goldman Sachs	82.9%
2	Thomas Lam , United Overseas Bank ²	80.0
3	Kurt Karl , Swiss Re	78.6
4	Richard Berner , David Greenlaw , Morgan Stanley	78.4
	Daniel North , Euler Hermes	78.4
6	David Rosenberg , Gluskin Sheff & Associates ³	77.6
7	Joshua Shapiro , MFR	77.5
8	Brian Fabbri , BNP Paribas	77.3
9	Sherry Cooper , BMO Capital Markets	77.2
10	Nariman Behravesh , IHS Global Insight	77.1

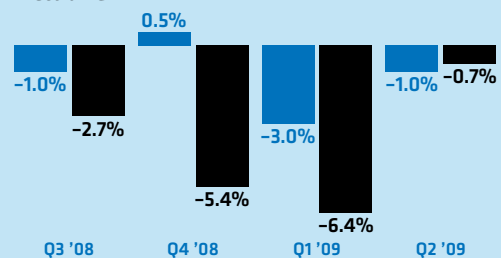
¹Average margin of error in forecasts for U.S. GDP, CPI, unemployment and federal funds rate for the four quarters ended on June 30, 2009, subtracted from 100. ²Lam left United Overseas Bank in November. ³Rosenberg worked at Merrill Lynch until May 2009. Source: Bloomberg

GDP

Accuracy score*

1	Jan Hatzius , Goldman Sachs	71.8%
2	Robert Carnell , ING Financial Markets	65.8
	Thomas Lam , United Overseas Bank**	65.8
4	Richard Berner , David Greenlaw , Morgan Stanley	64.5
5	Daniel North , Euler Hermes	64.3

Hatzius's forecasts Actual GDP



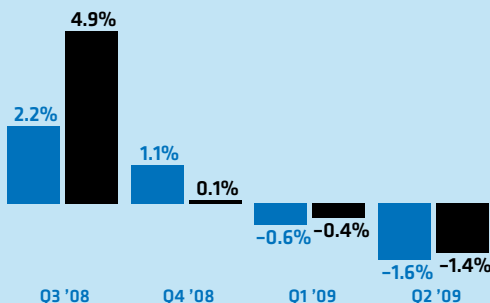
*Average margin of error for the four quarters ended on June 30, 2009, subtracted from 100. **Lam left United Overseas Bank in November. Source: Bloomberg

Consumer Prices

Accuracy score*

1	Kurt Karl , Swiss Re	89.8%
2	Francesca Panelli , Aletti Gestielle	89.3
3	Sherry Cooper , BMO Capital Markets	88.8
	Thomas Lam , United Overseas Bank**	88.8
5	Brian Fabbri , BNP Paribas	88.5
	Russell Price , Ameriprise Advisor Services	88.5

Karl's forecasts Actual CPI



*Average margin of error for the four quarters ended on June 30, 2009, subtracted from 100. **Lam left United Overseas Bank in November. Source: Bloomberg

Based on that, he wrote a note to clients predicting “an outright contraction” of the economy. The Cambridge, Massachusetts-based National Bureau of Economic Research, the official arbiter of when recessions begin, didn’t come to the same conclusion until almost a year later.

The Goldman veteran’s foresight helped propel him and his team to No. 1 among economic forecasters, according to data compiled by Bloomberg. Hatzius is also No. 1 among forecasters of U.S. gross domestic product and No. 2 among prognosticators of unemployment and of moves in the Federal Reserve’s target for its fed funds rate.

German-born Hatzius says high unemployment will continue through 2010, putting a damper on the recovery. He and his team, Edward McKelvey and Andrew Tilton, forecast in early October that unemployment would reach 10 percent by the end of 2009 and would average 10.3 percent for all of 2010. The following month, the government reported that joblessness had reached 10.2 percent.

The Bloomberg ranking of 65 forecasters covers the four quarters through June 2009, a period when the world’s largest economy shrank 3.8 percent. It includes estimates of GDP, unemployment, the fed funds target rate and movements in the U.S. consumer price index. Thomas Lam, a former economist for Singapore-based United Overseas Bank Ltd., is No. 2 overall and ties for No. 2 among GDP forecast-

ers. In November, he resigned from UOB and planned to start a new job as chief economist at OSK-DMG, a joint venture between Malaysian securities firm OSK Holdings Bhd. and Frankfurt-based Deutsche Bank AG, in December. Kurt Karl of Zurich-based Swiss Reinsurance Co. is No. 1 in forecasting U.S. CPI and the fed funds rate and is No. 3 overall.

Hatzius, 41, who has a Ph.D. in economics from Oxford University in England and has worked at Goldman since 1997, says that every time since World War II that unemployment spiked the way it did in 2007, a recession resulted. “That was probably the clincher that a recession either had just started or was about to start,” Hatzius says, speaking from his 45th-floor office at Goldman’s One New York Plaza headquarters, which overlooks New York Harbor and the Statue of Liberty.

As early as late 2008, the darkest period of the financial crisis, Hatzius, McKelvey and Tilton were forecasting that the U.S. economy would resume expanding in the third quarter of 2009. They were right; it grew 3.5 percent in that quarter. In August 2009, they said economic growth would be 3 percent in the second half of the year, slowing to an average of 2.1 percent for 2010, as the effects of President Barack Obama’s \$787 billion stimulus plan diminish.

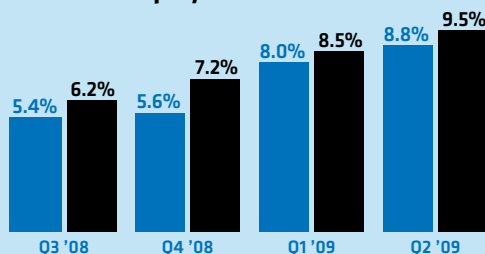
The most accurate forecasters of unemployment are Morgan Stanley economists Richard Berner and David Greenlaw.

Unemployment

Accuracy score*

1	Richard Berner, David Greenlaw , Morgan Stanley	91.5%
2	Jan Hatzius , Goldman Sachs	91.3
3	Nariman Behravesh , IHS Global Insight	89.8
	Thomas Lam , United Overseas Bank**	89.8
	Joshua Shapiro , MFR	89.8

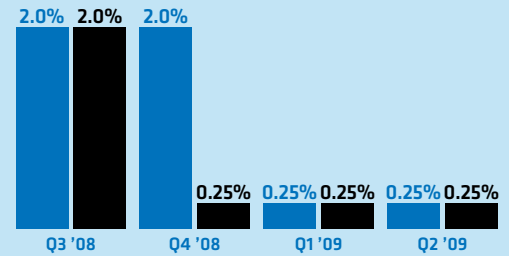
Berner and Greenlaw's forecasts Actual unemployment rate



*Average margin of error for the four quarters ended on June 30, 2009, subtracted from 100. **Lam left United Overseas Bank in November. Source: Bloomberg

Fed Funds Target Rate		Accuracy score*
1	Kurt Karl, Swiss Re	95.6%
2	Jan Hatzius, Goldman Sachs	92.5
	David Rosenberg, Gluskin Sheff & Associates**	92.5
4	Scott Anderson, Wells Fargo	91.7
5	Russell Price, Ameriprise Advisor Services	90.6

Karl's forecasts
Actual fed funds rate



*Average margin of error for the four quarters ended on June 30, 2009, subtracted from 100. **Rosenberg worked at Merrill Lynch until May 2009. Source: Bloomberg

Yet neither they nor Hatzius saw the full impact of the economic meltdown on job losses. In January 2009, Berner and Greenlaw projected unemployment rates of 8 percent and 8.8 percent for the first two quarters, respectively; the actual numbers were 8.5 percent and 9.5 percent. “As

Since the crisis, ‘there is just a lot more real-time interaction’ among economists, clients and traders, Greenlaw says.

much as we recognized the depth and the breadth of the recession as it unfolded, we failed to appreciate how devastating the impact would be on job loss,” says Berner, who holds a Ph.D. in economics from the University of Pennsylvania and has worked at Morgan Stanley since 1999.

Berner and Greenlaw believe jobs have been cut so sharply that companies will resume hiring faster than many financial firms are forecast-

ing. “Employers have been so aggressive in cutting jobs that if output picks up further, they’ll probably need to hire more quickly,” Berner says. He and Greenlaw predicted in early October that unemployment would drop below 10 percent by the second quarter of 2010 and average 9.5 percent in 2011.

Hatzius is more pessimistic. “I don’t think the economy is going to grow fast enough to produce rapid job growth,” he says. “The headwinds on private demand are still fairly significant, and the boost we’re getting from inventories and the stimulus is temporary.”

One development in which Goldman and Morgan Stanley’s economists take some satisfaction: Since the financial system began deconstructing in 2008, salesmen, traders and clients of their firms need them more than ever. “There is just a lot more real-time interaction,” says Greenlaw, Morgan Stanley’s chief U.S. fixed-income economist, who has a Master of Business Administration from New York University. He spends most of his days on the trading floor of the firm’s midtown Manhattan offices, advising his colleagues on the likely impact of economic trends on interest rates.

In December 2007, as Berner and Greenlaw made their own recession call, they huddled with Morgan Stanley’s foreign-exchange-strategy team trying to discern which way the dollar would move. Their conclusion: The crisis had triggered “increased uncertainty and risk aversion, and the dollar was going to strengthen on that,” Berner says. The dollar rose more than 16 percent from Jan. 1, 2008, to March 5, 2009, according to the U.S. Dollar Index, which tracks the dollar’s value versus six major world currencies.

Hatzius says Goldman’s economists also meet and talk with traders, analysts and strategists at the firm, along with the bank’s clients, as part of the process of drafting their research. When their research is published, the firm’s policy is to release it simulta-

How We Crunched the Numbers

To identify the best economists, we focused on estimates submitted to Bloomberg News for four key U.S. indicators: gross domestic product, the consumer price index, unemployment and the Federal Reserve’s target for its fed funds rate. We compiled estimates made by 65 economists in January 2008 and 2009 for four forecasting periods: the third and fourth quarters of 2008 and the first and second quarters of 2009. If an economist didn’t make a forecast in January, we counted the last forecast of the previous year. We included only economists who made at least three forecasts.

To determine the economists’ accuracy rating for each indicator, we calculated the error for every forecast by subtracting it from the actual figure. We totaled the errors and calculated the margin of error, which we then subtracted from 100. To get overall scores, we added an economist’s margins of error for all four indicators, giving GDP a double weighting because it’s so difficult to forecast. Then we divided by five and subtracted the result from 100.

The overall winner, Jan Hatzius of Goldman Sachs, had an accuracy score of 82.9 percent, the highest of the economists. On average, his forecasts deviated least from the actual figures.

Type OUTL 4 <Go> for Bloomberg News’s latest forecasts from economists.

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neously to both employees of the firm and outside clients.

John Coffee, a professor at Columbia University Law School in New York who specializes in securities law, says that's not always the case. "Information never gets to anyone at the same time, and the bigger customers usually get it first," Coffee says. He says it's legal for a firm to divulge economic research selectively so long as the firm doesn't trade on it before its clients see it. "It's probably a bad practice, but it's not insider trading," he says.

Swiss Re's Karl owes his No. 1 spot in the Bloomberg CPI ranking in part to a near-direct hit on inflation rates for the first half of 2009. In January, he said prices would decline 0.6 percent in the first quarter and 1.6 percent in the second; the actual numbers were -0.4 percent and -1.4 percent. Back in early 2008, Karl, 57, reasoned that oil, which surged to \$120 a barrel in early May from \$100 in February, could not keep rising without hobbling the economy. He bet accurately that rising oil prices, which reached an intraday high of \$147.27 on July 11, would quash demand, feeding into the broader economic slump that stamped out inflation and reversed the direction of oil prices.

Born in Eugene, Oregon, Karl has a Ph.D. in economics from Princeton University. He's had a varied career that included a 1980 stint as acting chief of the statistics office in the African nation of Swaziland and almost two decades with Wharton Econometric Forecasting Associates, an offshoot of Penn's Wharton School that was merged with Data Resources Inc. in 2001 to form Lexington, Massachusetts-based IHS Global Insight.

Karl publishes monthly U.S. outlooks at Swiss Re's clients as well as internal reports on global financial risk, which he presents to the company's eight-member investment committee. Justin Excell, London-based global head of rates and asset management at Swiss Re, who manages \$70 billion

in debt, says the committee has relied heavily on Karl's forecasts on inflation and interest rates. "He has a very important input in our portfolio construction," Excell says. He recalls that in mid-2008, when oil was approaching \$140 a barrel, Karl insisted oil prices and government bond yields would fall. "He never relented and always kept his view and proved to be very correct," Excell says.

Karl, Hatzius, Berner and Greenlaw all say the U.S. recovery from the worst recession since the 1930s will be slow and halting, with the creation of new jobs a determining factor. "In the last couple of recessions, we have taken a long time to get to positive employment growth," Karl says. "There is a lot of caution from firms to hire."

Hatzius and his team predict 2.1 percent average growth in 2010, while Karl anticipates a 2.5 percent expansion and Berner and Greenlaw look for 2.9 percent. "A jobless recovery ultimately is a jobless recovery because real GDP doesn't grow fast enough to produce rapid job growth," Hatzius says. For the more than 7 million people who've lost their jobs since the recession began, that's no recovery at all. **B**

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