



# Economic Outlook

## Forest and Wood Products Industries

February 2010

A P U B L I C A T I O N O F F O R E S T 2 M A R K E T ®

### Executive Summary

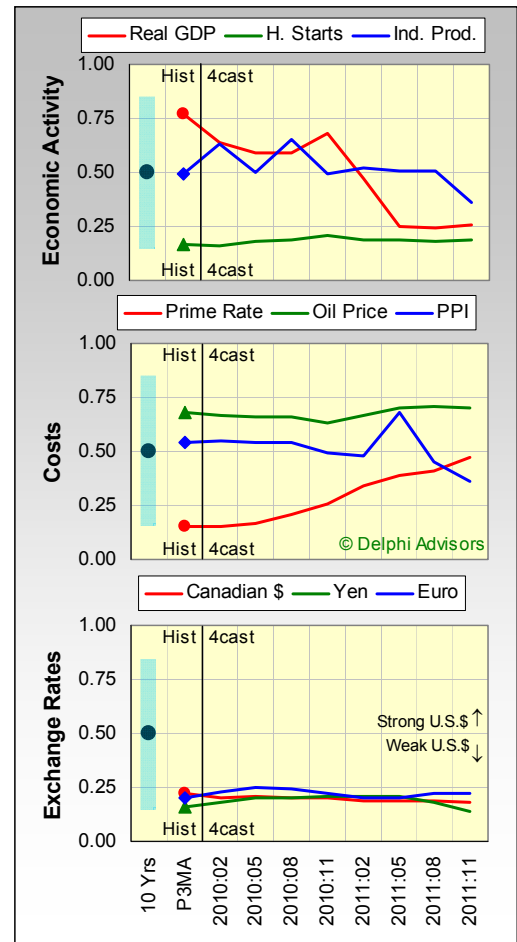
A slowdown in the rate of inventory destocking boosted 4Q2009 U.S. GDP growth to a six-year high of 5.7 percent. Export and/or domestic demand will need to be more tangible if growth is to be maintained or expanded; but eliciting greater demand for U.S.-made goods could prove challenging given the dollar's recent strength because of concerns over Europe's sovereign debt problems and expectations of continued high domestic unemployment. Most December indicators of housing market activity shriveled with the expiration of the initial federal home-buyer tax credit at the end of November. However, the upward trend in permits suggests the worst of the residential construction bloodletting may have already occurred. Rising interest rates will test the mettle, and ultimately dampen the magnitude, of the housing rebound over the next 24 months. When combined with a more burdensome tax structure in 2011, rising interest rates will return the U.S. economy to recession in 2Q2011. ■

### Economic Outlook

To make our macroeconomic forecast more accessible and reader friendly, we have changed this report so that only the forecast section is produced here. For those interested in its context (i.e., events that have occurred during the past month), please refer to the concurrent *Macro Pulse* newsletter on Delphi Advisors' website.\*

### Macroeconomic forecast

**Gross domestic product:** Many commentators anticipate the U.S. economy will gradually strengthen throughout 2010 and beyond; *Blue Chip's* February consensus forecast, for example, calls for real Gross Domestic Product (GDP) to grow 3.0 percent in 2010 and 3.1 percent in 2011. Similarly, the Federal Reserve's Survey of Professional Forecasters pegs real growth at 3.0 percent in 2010 and 2.9 percent in 2011.<sup>1</sup> This opinion is not shared by all, however. For example, MarketWatch.com commentator Paul Farrell identified 20 inextricably linked "made-in-America trigger mechanisms" that could detonate the "global debt time bomb."<sup>2</sup> Also, *Forbes* recently ran a series of articles on "The Global Debt Bomb."<sup>3</sup> Public sector budget deficits, unfunded mandates, and deflation of the real estate and cheap credit bubbles are among the triggers mentioned in those articles.



**Figure 1. Indexed forecasts of macroeconomic variables relative to their historical 10-year min, max and average (lower and upper ends of the blue bars, and black dots, respectively), and prior three-month averages ("P3MA"); see Table 1, p. 2., for full variable labels. Source: Delphi Advisors**

\* [http://www.delphiadvisors.com/macropulse/MP\\_201002.pdf](http://www.delphiadvisors.com/macropulse/MP_201002.pdf)

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**Table 1. Key economic 4cast statistics**

		Real GDP	Housing Starts	Industrial Production	Prime Rate	Oil Price	CDN\$ / US\$	Euro / US\$	Yen / US\$	PPI, Inter- med Materials
Actual	2009:11	5.59	0.580	-0.09	3.25	78.08	1.059	0.671	89.3	0.86
	2009:12	5.56	0.557	0.96	3.25	74.30	1.054	0.686	90.0	0.23
Estimated	2010:01	3.40	0.550	-1.25	3.25	78.22	1.044	0.701	91.1	0.17
	2010:02	3.68	0.575	3.19	3.25	76.65	1.040	0.710	93.7	0.37
	2010:03	2.82	0.512	2.09	3.25	74.46	1.032	0.702	92.2	0.46
	2010:04	2.69	0.509	-2.55	3.25	76.78	1.019	0.712	92.1	0.56
	2010:05	2.61	0.602	0.24	3.25	76.04	1.026	0.720	92.4	0.15
	2010:06	2.48	0.654	1.32	3.25	75.15	1.039	0.734	94.2	-0.29
	2010:07	2.56	0.746	-1.80	3.75	70.07	1.056	0.745	95.5	1.44
	2010:08	2.43	0.650	2.49	3.75	69.27	1.042	0.737	95.4	-0.12
Projected	2010:09	1.94	0.714	0.20	3.75	77.42	1.020	0.722	94.0	0.33
	2010:10	3.49	0.812	0.50	4.25	76.98	1.003	0.711	93.1	1.06
	2010:11	3.77	0.773	0.52	4.25	73.40	1.010	0.713	93.8	-0.26
	2010:12	3.37	0.842	-0.87	4.25	68.66	1.021	0.702	95.2	0.75
	2011:01	3.14	0.892	-0.11	4.75	69.89	1.028	0.702	96.7	0.05
	2011:02	3.01	0.780	1.87	4.75	69.71	1.019	0.697	96.5	-0.64
	2011:03	2.80	0.703	1.29	4.75	77.56	1.009	0.678	94.8	0.36
	2011:04	-1.64	0.747	-2.89	5.25	81.27	0.993	0.679	94.1	0.54
	2011:05	-1.52	0.704	0.17	5.25	78.66	0.994	0.675	94.1	0.87
	2011:06	-1.37	0.722	2.25	5.25	79.94	1.006	0.682	95.5	0.72
	2011:07	-2.75	0.650	-2.32	5.25	83.03	1.019	0.688	96.3	1.13
	2011:08	-2.68	0.605	0.78	5.25	82.85	1.018	0.698	94.8	-0.10
	2011:09	-2.82	0.699	-0.82	5.25	82.97	1.008	0.700	92.1	-0.64
	2011:10	-0.93	0.627	0.08	5.50	81.21	1.001	0.705	90.0	0.28
2011:11	-0.96	0.706	-0.58	5.50	77.72	0.998	0.703	88.8	-0.30	
2011:12	-1.05	0.708	-1.83	5.50	77.75	0.995	0.695	88.1	0.13	
2012:01	-1.81	0.755	-1.09	6.25	83.85	0.990	0.696	87.2	-2.39	

Notes: All actual data from St Louis Federal Reserve Board's FRED database unless otherwise indicated.  
Real GDP is annualized percentage change (chained 2000 US dollars)  
Housing Starts are millions of units (seasonally adjusted, annualized rate) as reported by U.S. Census Bureau  
Industrial Production is monthly percentage change in index (index not seasonally adjusted) as reported by the Federal Reserve's G-17 report  
Prime lending rate is monthly average of daily figures  
Oil price is West Texas Intermediate crude, monthly average of daily \$/barrel  
Canadian dollar, euro and yen exchange rates are monthly averages of daily figures  
Monthly percentage change in Producer Price Index, intermediate materials, as reported by Bureau of Labor Statistics  
Projections developed by Delphi Advisors

With respect to the risks imposed by public sector debt, a new report reviewing 200 years of economic data from 44 nations concluded that, almost without exception, countries that are as highly indebted as the United States is today grow at sub-par rates. The study by Carmen Reinhart at the University of Maryland and Harvard University's Kenneth Rogoff found that when a nation's debt exceeds 60 percent of its GDP, its growth rate slows precipitously. When that ratio exceeds 90 percent, the nation's economy barely grows, and can even go into decline. The U.S. national debt is at roughly 84 percent of the country's GDP, and it is projected to cross the 90 percent threshold late this year or early next year. The authors do not say the U.S. economy cannot grow briskly despite even higher debt; if it does, however, it would be an outlier in roughly 200 years of economic precedent.<sup>4</sup>

Our own view of U.S. economic growth prospects is not as robust as the *Blue Chip* consensus, largely due to the impacts of significant public debt. While for 2010 we anticipate real growth to average 3.1 percent, the trek to achieve it will be uneven. In light of developments detailed in subsequent sections of this report, we expect 1Q2010 GDP growth to moderate from 4Q2009's level,

but still achieve above-trend growth of 3.4 percent. During the middle portion of 2010, growth will drift lower as uncertainty over the global recovery undermines global demand, while persistently high unemployment in the United States will mute consumer demand. In addition, we expect U.S. interest rates will begin to increase by mid-year 2010.

A spurt of growth in 4Q2010 and 1Q2011, stemming primarily from federal government stimulus spending, will temporarily reverse mid-2010's slowing growth. However, the economy will begin to contract once again in 2Q2011 under the combined weight of rising interest rates and the full impact of expiring tax cuts. Real growth will be positive for all of 2011 (averaging 1.2 percent for the year) but the last three quarters will be in negative territory. Table 1 provides monthly details of our GDP forecast, while Figure 1 (p. 1) places the forecast in its historical context.

The remaining sections of this report provide underpinning for our GDP forecast.

**Manufacturing and service sector activity:** For a change, both the Wood and Paper Products industries indicated a

pick-up in overall activity during January, although details were rather sketchy (Table 2).<sup>5</sup> Particularly important were rising new orders and falling customers' inventories. Of the service industries that have a relatively direct relationship to forest products, only construction posted a gain in overall activity. It is interesting to note that Real Estate was not mentioned at all in the Institute for Supply Management's (ISM) service sector report, which implies that the industry was essentially unchanged in January. One Agriculture, Forestry, Fishing and Hunting respondent indicated, "business is better, but not robust."

"If there's one sector of the economy to point to that says things are recovering quite nicely, it's factories," said Michael Gregory, a senior economist at BMO Capital Markets in Toronto. "There's foreign demand, but also both domestic and foreign businesses are focused on improving productivity and that means greater capital spending." Boosted by investment in business equipment, orders placed with U.S. factories rose 1.0 percent in December, the fourth straight monthly increase (Figure 2).<sup>6</sup> Excluding transportation, orders increased 1.2 percent. Orders for durable and non-durable goods each rose 1.0 percent.

If the rebound in manufacturing that began mid-year 2009 can be maintained (e.g., Wood Products industrial production is up 4.3 percent since May; Paper Products: +7.4 percent since April), the recovery will gradually spread to the service sector as well. "The economy will continue to grind forward at a fairly moderate pace this year," said Sal Guatieri, a senior economist at BMO Capital Markets Inc. in Toronto. "It's very weak momentum in the broader economy outside of factories."

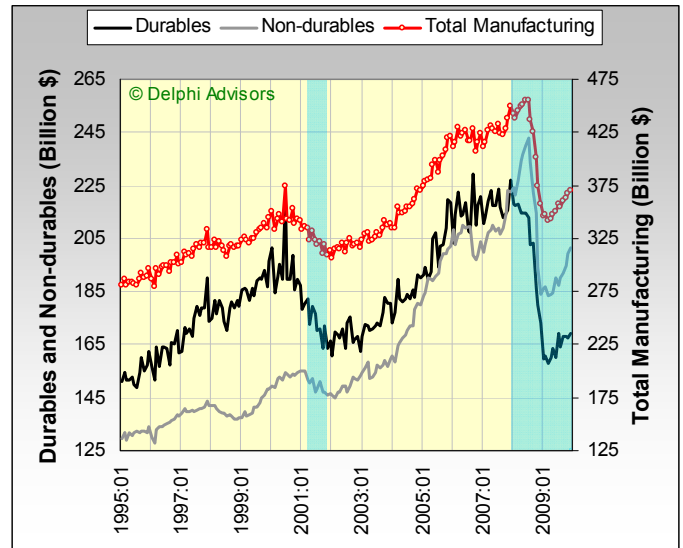
Although now a bit dated, in December ISM's Business Survey Committee released a rather upbeat forecast for both the manufacturing and service sectors of the U.S. economy.<sup>7</sup> "Expectations for 2010 are positive as 60

**Table 2. Performance overview of selected industries.**  
Source: Institute for Supply Management

Category	January 2010				
	Wood Products	Paper Products	Real Estate	Construction	Ag. & Forestry
Overall activity	▲	▲	—	▲	—
New orders	▲	▲	—	▲	—
Production	—	▲	—	—	—
Employment	—	—	—	▼	—
Pace of supplier deliveries	—	—	—	—	—
Inventories	—	—	—	—	▼
Customers' inventories	▼	▼	—	—	—
Input prices	—	▲	—	▲	—
Backlog of orders	—	▲	—	—	—
New export orders	—	—	—	▲	—
Imports	—	—	—	▼	▲

▲ = increase, higher or faster  
— = no change, or no mention  
▼ = decrease, lower or slower

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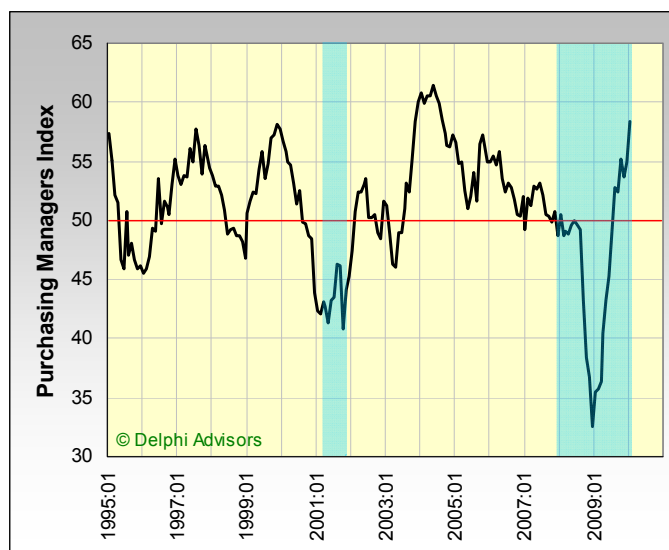
**Figure 2. Seasonally adjusted value of new orders, by sector; recessions shown in blue. Sources: Census Bureau and National Bureau of Economic Research**

percent of [manufacturing] survey respondents expect revenues to be greater in 2010 than in 2009," the report stated. "The panel of purchasing and supply executives expects a 5.7 percent net increase in overall revenues for 2010, compared to a 10.7 percent decrease reported for 2009." Paper Products was on the list of industries expecting improvement over 2009, but Wood Products was not.

On the service-sector side, "40 percent of non-manufacturing supply management executives expect their 2010 revenues to be greater than in 2009. They currently expect a 1.3 percent net increase in overall revenues for 2010 compared to a 4.5 percent decrease reported for 2009." Real Estate, Rental & Leasing and Agriculture, Forestry, Fishing & Hunting were among the eight non-manufacturing industries expecting revenue improvement in 2010 over 2009. Construction was not on the list.

Employment and consumer spending: ISM's purchasing managers' index (PMI) and change in non-farm employment generally move in tandem,<sup>8</sup> so the January rise in PMI<sup>9</sup> (Figure 3, p. 4) is a potentially encouraging sign for employment. Nonetheless, two years could easily be required to accommodate the pool of workers needing to be "reabsorbed into the system." Approximately 25.6 million workers remain under-employed (16.5 percent of the labor force<sup>10</sup>) in January, including:

- 14.8 million officially unemployed;
- 8.3 million persons working part time for economic reasons (down from 9.2 million in December);

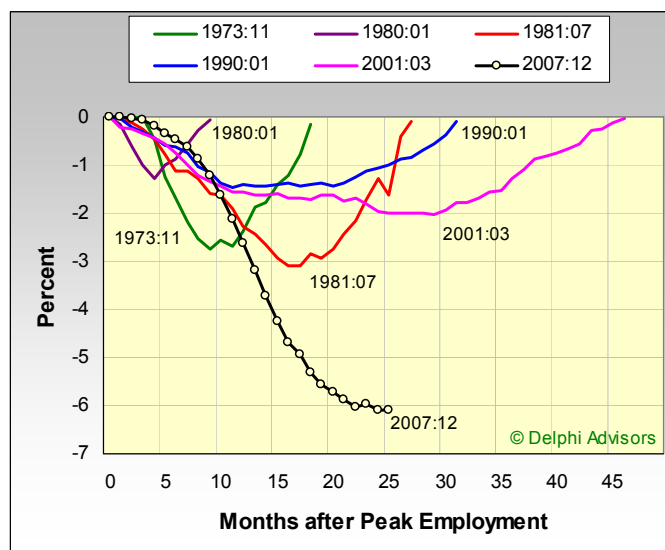


**Figure 3.** Purchasing managers' index for manufacturers; an index of 50 is the threshold between expansion and contraction. Recessions shown in blue. Sources: Institute for Supply Management and National Bureau of Economic Research; taken with permission from Delphi Advisors' *Macro Pulse* newsletter

- 2.5 million “marginally attached” to the labor force – including 1.1 million “discouraged” workers (persons not currently looking for work because they believe no jobs are available for them) and another 1.4 million who had not searched for work in the four weeks preceding the survey.

Progress toward reemploying those workers will be fraught with setbacks. For example, after falling to a nine-year low of 45,094 in December, planned layoff announcements at major U.S. corporations jumped 59 percent in January, reaching 71,482, according to the latest job-cut tally by Challenger, Gray & Christmas. It was the first month-to-month increase since July.<sup>11</sup>

The Congressional Budget Office predicts the jobless rate will remain above 8 percent until 2012,<sup>12</sup> a contention that seems quite plausible given the patterns of job gains following recessions since 1970 (Figure 4), and the realization that the economy needs to create 100,000 new jobs each month just to keep up with population growth.<sup>13</sup> Not surprisingly, we expect consumer spending to reflect employment trends, which will dampen U.S. economic growth. Sustaining “potential growth” rates (generally regarded as 2.5 to 3.0 percent real) while unemployment rates remain near double-digit levels seems unrealistic. Last year Mohammed El-Erian of PIMCO described a “new normal” for the U.S. economy after it emerges from the recession: 8 percent unemployment and 2 percent real growth in GDP.<sup>14</sup> While we do not necessarily subscribe to these levels as the “new normal,” the relationship of 8 percent unemployment and sustaining real GDP growth of 2 percent seems reasonable.



**Figure 4.** Non-farm employment losses as a percentage of peak recessionary employment, by month after peak employment of each recession since 1970; series labels refer to the first month of the corresponding recession. Source: Bureau of Labor Statistics

Interest and currency exchange rates: Concern over the sovereign debt of Greece and other European countries appears to be driving investors out of the euro and back into the perceived safety of dollar- and yen-denominated assets. The result is that the U.S. dollar is likely to appreciate against most of the currencies we track until either the “all clear” signal sounds or something tarnishes the safe-haven image of the United States. The “all clear” signal will be prompted by a decision within the European Union (EU) to backstop the debt of Greece and other cash-strapped EU economies. The timing of such a decision is difficult to predict but we expect a package to be assembled within a matter of weeks – not months.

Canada’s loonie is an exception to our expected short-term appreciation of the U.S. dollar. That country’s rebounding economy (+0.4 percent in November<sup>15</sup>), global demand for its commodities, and diversification of foreign reserves by some central banks into the Canadian dollar<sup>16</sup> should be sufficient to maintain the trend toward parity with the greenback. Such an outcome could result in Canadian forest products manufacturers ceding more of their share of the U.S. market.

As for the United States’ safe-haven image, long-time readers know we have maintained that fiscal fundamentals argue for a substantial downgrade of confidence in the U.S. market (with an attendant weakening of the dollar and corresponding increase in U.S. treasury yields), but that the economy has so far managed to avoid such an outcome. At the risk of being accused of

crying “wolf!” we continue to believe it is a matter of when, not if, such a breakdown of confidence will occur. We can only shake our heads when observing skittish investors understandably recoiling at the debt of Greece, Portugal, Italy, Ireland and Spain (which collectively have a deficit of 11.4 percent relative to GDP) while simultaneously according safe-haven status to the United States (which has a deficit of 10 percent relative to GDP). Further, while the four EU countries are at least preparing plans designed to trim their deficits to below the EU’s mandated 3 percent of GDP, the fiscal year 2011 U.S. budget proposes to more than double the national debt within 10 years (i.e., U.S. deficits will expand each year).<sup>17, 18</sup> For more in-depth comparisons between U.S. and EU debt, see Delphi Advisors’ *Macro Pulse* newsletter.

The longer-term picture is equally bleak for the United States:

“...the Office of Management and Budget [OMB] reports in its long-term, inter-generational budget projection that the United States government will experience massive, non-stop deficits for the next 70 years, requiring the issuance of tens of trillions of dollars of additional debt. The OMB does not project even one year of surplus during the entire 70-year budget period.”<sup>19</sup>

There are at least two morals to Greece’s sovereign debt crisis: The first is that such problems, even those of a comparatively small country, can profoundly destabilize the world’s economy – especially one as fragile as today’s.<sup>20</sup> The second is that markets have a finite tolerance for economic and fiscal mismanagement. Eventually, lenders become concerned that the risks of maintaining investments in certain countries outweigh the rewards. At first, they demand a higher interest rate to compensate for the greater perceived risk (which has happened in the case of Greece); if the mismanagement continues and/or worsens, investors ultimately move their money out of harm’s way.

We think a comparable situation is unfolding (or is about to) in the United States. The warning by Moody’s Investors Services that the United States’ triple-A credit rating will come under pressure unless economic growth is more robust than expected or tougher actions are taken to tackle the country’s budget deficit is but one indicator of the storm brewing “on the horizon.”<sup>21</sup> Just as the Greek government would prefer to keep bond rates low to enhance liquidity and ease debt service payments, the Federal Reserve is “pulling out all of the stops” in an effort to keep rates low in this country

(which also protects the value of its portfolio of “toxic” mortgage backed securities).<sup>22</sup> In the case of Greece, however, its central bank has lost control over interest rates; in our opinion, it is only a matter of time before the same thing happens in the United States. If/when that happens (our guess is by mid-2010), rates will begin to increase whether or not the Federal Reserve wants them to<sup>23</sup> – a situation that will almost certainly precipitate another recession.

We should point out the risk of lending to the United States, for now at least, is not so much one of defaulting on the debt but of inflation risk. If the United States meets its debt obligations by increasing the money supply and precipitating inflation, lenders to the U.S. will be repaid with currency that is declining in value. Their response will be to demand a higher rate of interest as compensation for the inflation risk.

In a similar vein, the magnitude of deficits being run by the governments of the developed world almost guarantees that interest rates will rise. Assuming the world economy continues to recover, other investment vehicles will at some point begin to pay better returns than the low-yielding government bonds presently are. To expect that significant capital – and given the magnitude of the deficits, the amount of capital needed is very significant – will continue to be directed at low yielding government bonds when higher-yielding investments are available, is – in our opinion – naïve at best. In summary, then, we believe two market forces will ultimately force U.S. interest rates higher whether or not the Federal Reserve decides to raise rates. One market force involves investors being compensated for inflation risk, while the other relates to the rationing of scarce capital.

So, while the dollar may strengthen temporarily against the other currencies we track – especially the euro – the consequences of fiscal indiscretions in the United States will come home to roost and drive down the value of the dollar. At the same time, the Chinese and other countries will take advantage of the near-term dollar strength to sell dollars as part of their announced diversification strategies. This will at least cap the greenback’s appreciation, while heightening risk of further weakness in the future.

International trade: Our view regarding international trade is somewhat mixed. In the short term, dollar weakness against the loonie will enable U.S. manufacturers to compete more effectively against their Canadian counterparts. At the same time, however, dollar strength against most other currencies will trim U.S. exports to much of the rest of the world. Long-term prospects are better

overall for domestic producers, however, as we think the dollar will revert to its weakening trend over time.

**Construction:** The housing market is exhibiting some positive signs (see *Macro Pulse* for a more in-depth overview of recent construction activity). For example:

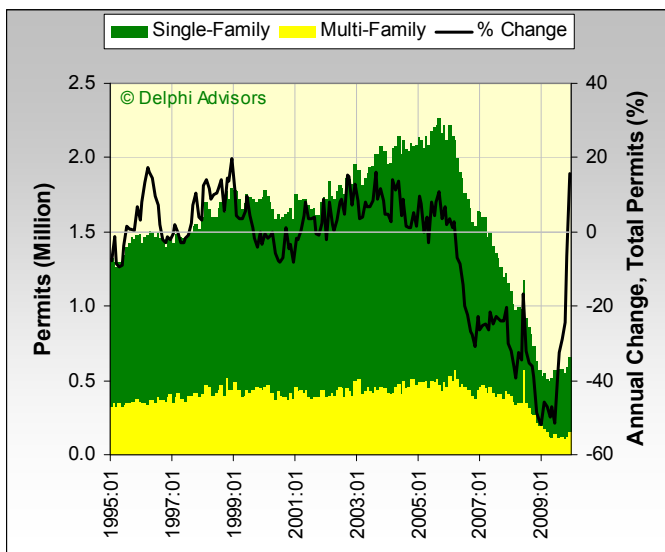
- Building permits finally trended higher on a year-over-year basis in December (Figure 5),<sup>24</sup>
- Harvard University's leading indicator of remodeling activity seems poised to rise in 2010,<sup>25</sup> and
- The National Association of Realtors' pending home sales index rose 1 percent in December.<sup>26</sup>

Even so, a dramatic and sustained near-term rebound in solid wood demand does not appear very likely for the following reasons:

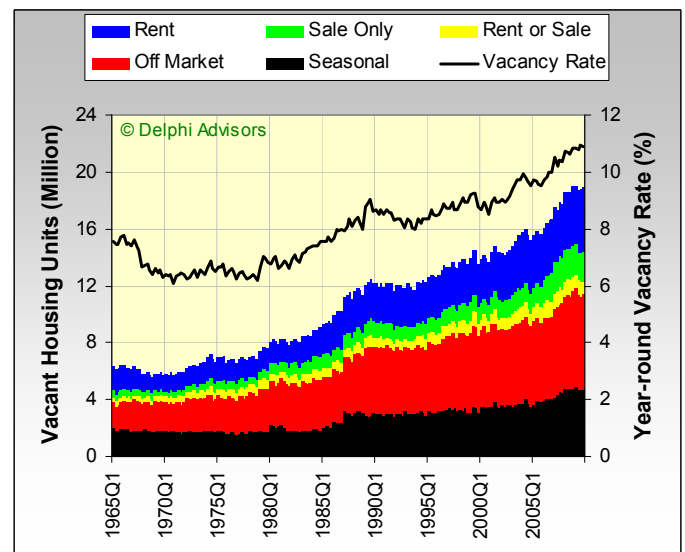
- Homes standing vacant year-round as a proportion of the total housing stock remains at an all-time high (Figure 6). In our opinion, that high vacancy rate implies either that there may not be as much pent-up demand for housing as some claim, or at least that existing inventory is sufficient to satisfy much of that demand.
- Foreclosures will continue to be a problem in 2010. According to RealtyTrac, a record 2.8 million properties with a mortgage got a foreclosure notice last year, 21 percent more than in 2008 and 120 percent higher than 2007. The loan failure rate – and thus the fallout for home prices and the economy – would have been even worse without foreclosure prevention programs and loan processing delays caused by sheer volume,

the company said. However, in many cases loan fixes do not “stick”; thus, RealtyTrac expects a new record of at least 3 million properties to get a filing in 2010.<sup>27</sup>

- In a similar vein, hundreds of thousands of troubled homeowners who are making lower mortgage payments on a trial basis are at risk of being kicked out of the Federal foreclosure-prevention program. Companies that service the mortgages had until 31 January to review all trial modifications under the Home Affordable Modification Program (HAMP). But paperwork has proved a major obstacle. Homeowners complain that servicers keep losing the documents they send in, while financial institutions argue that borrowers have not been sending in their paperwork. “About 450,000 homeowners currently have HAMP trial modifications and have demonstrated a willingness and ability to make timely payments for at least three months,” said Richard Neiman, superintendent of the New York State Banking Department. “Now, unfortunately and very alarmingly, these same homeowners face the prospect of foreclosure strictly on account of documentation issues,” he said.<sup>28</sup>
- Banks have half a million houses on their books yet to be put on the market, and there are another million properties in foreclosure and 5.5 million delinquent loans. “The doomsday prognostications say that gives you 7 million properties that are all going to go back to the banks, that are all going to hit the market at the same time and we’re going to have a smoking crater where there used to be a real estate market,” said Rick Sharga, senior vice president at RealtyTrac. “We just don’t see that as being realistic.” It is widely seen in the best interest of banks, housing market and the



**Figure 5.** Components of total housing permits versus annual percentage change in total permits; data are seasonally adjusted and annualized. Source: Census Bureau

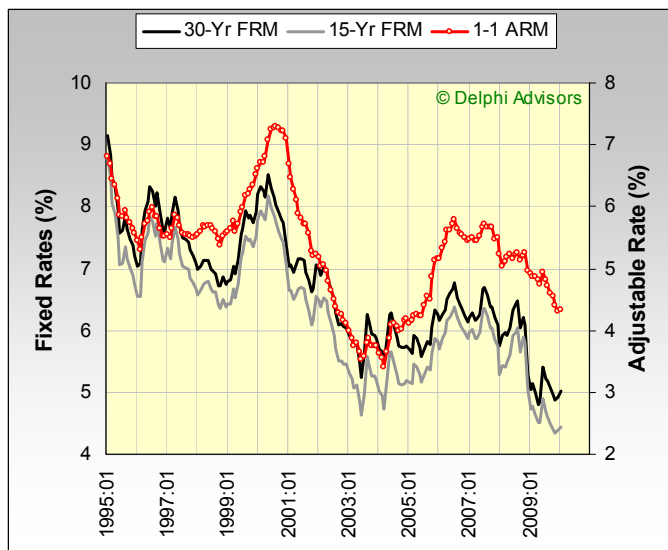


**Figure 6.** Housing vacancies, by type, versus year-round vacancies as a percentage of total housing inventory. Source: Census Bureau

economy for the banks to sell the foreclosed homes in a measured way to prevent prices from swooning anew. “Because of gradual foreclosure bank sales, we’re looking at a long, slow, flat housing market recovery that probably won’t feel much better until about 2013,” he said. “But if it means we avoid a double dip in housing then that’s probably a good thing.”<sup>29</sup>

- Although mortgage interest rates fell at the end of 2009 when investors piled into mortgage-backed securities,<sup>30</sup> we think rates are at a cyclical low, and likely to add to January gains (Figure 7). One reason for our expectation is that the Federal Reserve is scheduled to end its purchases of mortgage debt in March,<sup>31</sup> Boston Federal Reserve Bank President Eric Rosengren recently indicated removal of that accommodative monetary policy would force rates higher.<sup>32</sup> Longer term, we expect interest rates of all types to rise in response to concerns over both sovereign and private-sector debt risks (see interest and exchange rate section above). Should such a scenario unfold, it will dampen demand for home purchases.

If interest rates rise significantly, their doing so will have an adverse impact on home prices. The rebound in home prices is already on shaky ground, and Robert Shiller, co-creator of the S&P/Case-Shiller index, thinks there is a better-than-even chance that prices will decline again.<sup>33</sup> Shiller’s view is shared by housing economist Dean Baker, co-director of the Center for Economic and Policy Research, who thinks the U.S. housing market is still in a bubble. Baker observed that, adjusted for inflation, home prices are still 15 to 20 percent higher than they were in the mid-1990s. “There’s no plausible fundamental explanation for that,” he said,



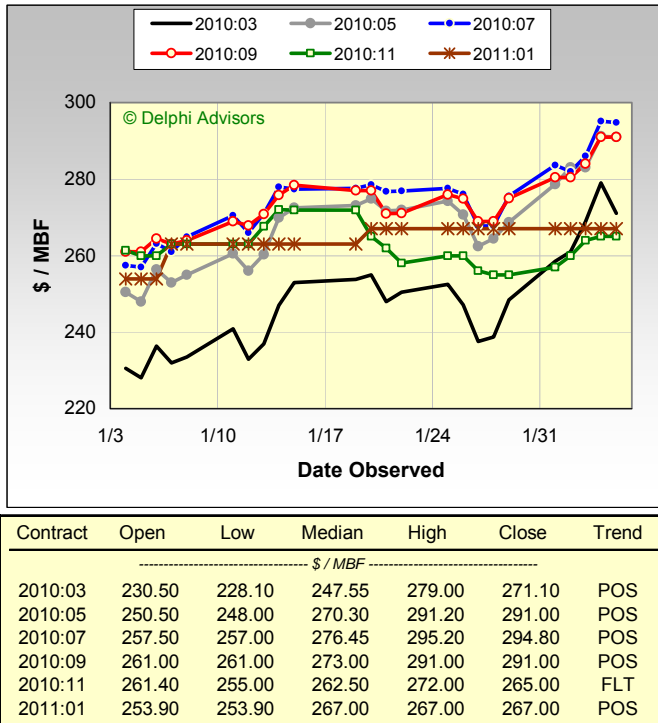
**Figure 7. Monthly average mortgage rates, by mortgage type. Source: Freddie Mac**

especially since rental apartment vacancies are reaching record highs and many segments of the housing market are still oversupplied. Worse, the core demographic in the country – the baby boomers – are reaching the age at which they are more likely to downsize, buying less house in the years to come. Rather than assuming that housing is going through a temporary, once in a lifetime downturn and that after the market bottoms, homes will again appreciate well beyond the rate of inflation, Baker argues that home prices are far more likely to increase annually at the rate of inflation, at best. “If anything, I expect housing to be weaker than normal rather than stronger over the next decade,” he says. “People who say this is a temporary story, there’s no real reason to believe anything like that.”<sup>34</sup>

Taking all of the above into account, our view is that while the downturn in construction has likely bottomed, the subsequent rebound will be quite muted by historical standards. It will also be vulnerable to another retreat if the economy contracts in late 2010 or early 2011 as we expect. We forecast housing starts to average 662,000 units (SAAR) for all of 2010, which will be a modest improvement over 2009’s 552,000 units. After the 1Q2010 flurry, during which starts will average 545,000 units, April 2010 will mark the low point for the calendar year at 509,000 units. Activity will trend higher from April, with the peak for the year occurring in December 2010 at 842,000 units. January 2011 will start “hot,” at nearly 900,000 units, but the slowing U.S. economy and higher interest rates will pull the rug from beneath further progress. As a result, housing starts will tumble to a bottom for the year in August at 605,000. For 2011, housing starts will average 696,000 units.

Futures traders have had a difficult time making up their minds about what trajectory lumber prices are likely to take. Prices for most delivery dates trended higher over the five weeks shown in Figure 8 (p. 8), but with notable setbacks. Most activity was on near-term contracts, indicative of pricing support seen lately from supply shortages due to lean inventory coming off December holiday shutdowns and bad weather through much of the southeast United States. It is noteworthy to observe that traders appear to be expecting another slowdown in demand in late 2010, as the closing prices for November 2010 and January 2011 are considerably lower than those with delivery dates earlier in 2010.

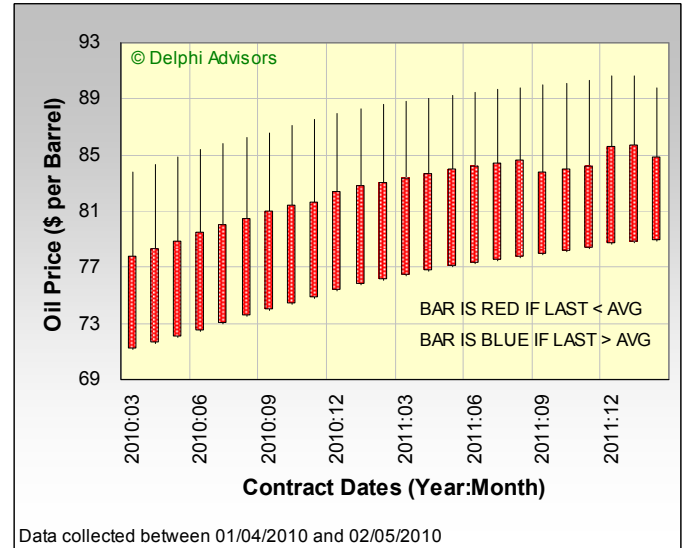
**Energy:** Crude futures prices stayed in about the same range during January as they had in December, but traders were decidedly more pessimistic during January. Whereas the last prices (7 January) observed for Janu-



**Figure 8.** Statistics of prior five-week lumber futures prices, by contract delivery month. Source: Chicago Mercantile Exchange

ary's report were at the top of the range, the final prices for this report were at the bottom of the range (Figure 9).

ASPO-USA's 1 February issue of *Peak Oil Review* offers a succinct summary of the challenges involved with forecasting oil prices: "The effect of [skepticism over the 4Q2009 U.S. GDP growth estimate, the burgeoning U.S. federal deficit and the willingness of foreign investors to underwrite it, and declining public sector revenues] on oil prices is problematic. Commercial and Organization for Economic Cooperation and Develop-



**Figure 9.** Futures prices for light crude oil by delivery month. The vertical black lines represent the range of closing prices during the data-collection period; the colored bars show the relationship between the last observed and average closing prices. Source: New York Mercantile Exchange

ment demand for oil products will probably continue to decline for the [near] future. Whether Asian demand for more oil will grow fast enough to offset this decline and lead to higher prices will be the question of the year."<sup>35</sup>

Weak global growth will keep energy prices in check through most of 2010 and early 2011 (bottoming out at \$68.66 in December 2010). However, the weaker U.S. dollar and recovering economies in India and China will provide sufficient lift to cause crude oil prices to move higher throughout latter half of 2011, pushing above \$80 per barrel by early 2012. ■

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