

Top '09 Forecasters Saw Bad Times

By **JUSTIN LAHART**

The two Morgan Stanley economists who beat 50 other forecasters in guessing how bad 2009 would be did it by predicting soaring unemployment—though even they didn't see it hitting 10%—and a U.S. economy that would start sputtering back to life by the end of the year.

All the survey economists, to some degree, were blindsided by the depth of the recession.

Unfortunately for these professional prognosticators, the wheels really started coming off the economy shortly after they submitted their annual predictions to The Wall Street Journal at the beginning of 2009. "It seems so long ago, but there was something bordering on panic" as the first months of the year unfolded, says Richard Berner, who was joined by David Greenlaw on the Morgan Stanley team that took first place in the ranking.

The two are much more upbeat about 2010, reckoning that the economy will continue to recover and that by the end of the year the unemployment rate—the Achilles' heel of the current economic revival—will have begun to edge lower.

Nearest to the Mark

Top-ranked economists in the 2009 Wall Street Journal survey of economic forecasts

	Unemp. rate	GDP	PCE price index	Core PCE	Fed funds rate target
Richard Berner/ David Greenlaw Morgan Stanley	9.4%	-1.1%	0.7%	11%	0.125%
Kurt Karl Swiss Re	9.0	-0.4	0.5	0.8	0.250
Jan Hatzius Goldman Sachs	9.0	-0.5	0.5	1.0	0.125
Mike Cosgrove Econoclast	8.8	-0.5	0.9	1.2	0.500
Sung Won Sohn California State University	9.3	-1.5	0.5	1.5	0.050
Actual data	10.0%	0.1%	1.3%	1.4%	0-0.25%

Note: Figures are average 4Q unemployment rate; 4Q-4Q change in GDP, price index for personal consumption expenditures and PCE excluding food and energy prices; and year-end federal funds rate target
Source: Commerce and Labor departments (actual figures)

At the start of last year, Messrs. Berner and Greenlaw figured that inflation would stay tame, and they correctly predicted that the Federal Reserve would stick to its policy of keeping interest rates near zero. through the end of the year

It was their prediction on unemployment, however, that catapulted them to the front of the pack. The team saw the unemployment rate averaging 9.4% in the fourth quarter of 2009. That was the second-most-bearish labor-market prediction among the 51 forecasters surveyed. The economists said their work with Morgan Stanley's industry analysts helped them foresee the surge of joblessness, with analysts warning that companies were slashing costs far faster than anyone thought they would.

As for the year ahead, Messrs. Berner and Greenlaw predict that by the fourth quarter, gross domestic product will rise 3.2% above its year-earlier level, a forecast that puts them among the more bullish half of economists surveyed. That will push unemployment only slightly lower, down to 9.7%, in part because people who have left the job market will be rejoining the job seekers. They also see inflationary pressures building, which they expect will prompt the Fed to raise its target rate to 1.5%.

Swiss Re economist Kurt Karl came in second in the 2009 survey. His forecasts for inflation were too low in comparison to Messrs. Berner and Greenlaw's, and his unemployment rate forecast, at 9%, was also lower. But his forecast for GDP, the broadest measure of the value of goods and services produced by the economy, at year end was better. He estimated that fourth-quarter GDP would be 0.4% below its year-earlier level, compared to the Morgan Stanley economists' 1% drop. In fact, GDP eked out a 0.1% gain.

Rounding out the top three spots was Goldman Sachs economist Jan Hatzius, who took the top honors in the 2008 rankings.

Bringing up the rear in this survey was Bank of Kuwait economist William Wilson, whose overly bearish forecast earned him the lowest ranking. He looked for GDP to fall by 2.5% and for that to push prices lower. Mr. Wilson, who lives in Beijing, thinks that what he missed was the strength of the global economic recovery, particularly in countries like China, and how that would bolster the U.S. economy.

"That's paradoxical because I think I am the only one on the panel that lives abroad and focuses exclusively on the emerging markets," he said.

Second from the bottom was James Smith, chief economist for Parsec Financial Management in Asheville, N.C., who made the opposite mistake of being far too bullish. He saw GDP growth of 3.4% and a fourth-quarter unemployment rate of 5.7%. He said his biggest error wasn't realizing how badly the collapse of Lehman Brothers in September 2008 would affect the economy. Here are the five criteria used to rank the economists: Their estimates for GDP growth from the fourth quarter of 2008 to the fourth quarter of 2009; their inflation estimates, as measured by the price index for personal-consumption expenditures including and excluding food and energy prices; their estimates for the fourth-quarter average unemployment rate; and their year-end forecast for the Fed's target rate.

They submitted those estimates to The Wall Street Journal in January 2009. The ranking methodology, created by Federal Reserve Bank of Atlanta economists, compensates for distortions that arise when the numbers get smaller. It also makes adjustments for the difficulty of forecasting

volatile measures such as GDP and the tendency of some measures, such as inflation and interest rates, to move in sync.