MACRO PULSE™

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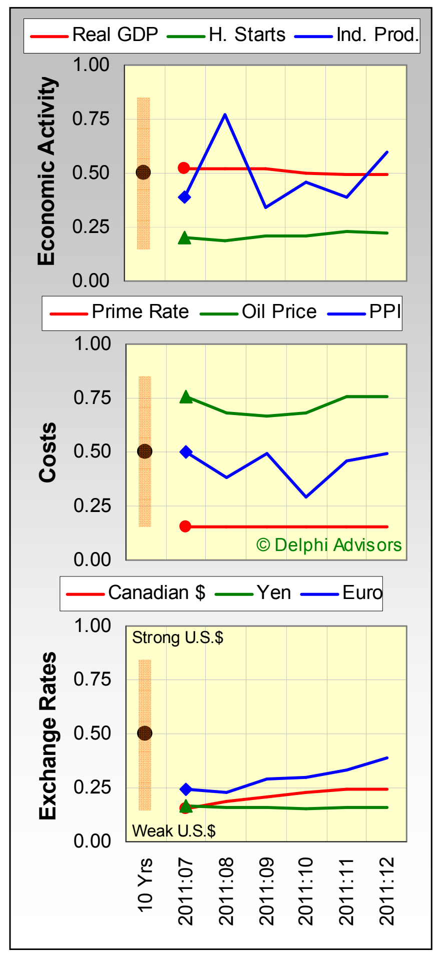
Forecasting in a Blizzard

Dating in the upper Midwest during the early 1980s sometimes meant returning home in the dead of night and amidst a blinding snowstorm. There was no feeling quite like being unable to tell which ditch the car was heading toward, and – having no cell phone – knowing that ending up in one could mean either hours alone in a freezing cold car or a miles-long slog through the drifts. Economic forecasting has a bit of that same feel right now. Each statistical release, news blurb and blog commentary is like a snowflake. They come in an unending flurry, swirling every which way until one has a difficult time telling whether the economy is growing or contracting, and in what direction it is likely to head. Despite conflicting evidence (examples follow), and as described more fully in our *Economic Outlook* (details below), we believe the U.S. economy will fall into a year-long recession sometime in 1H2012.

• Employment and personal income – Non-farm payrolls rose by 200,000 jobs in December, and the unemployment rate dropped to 8.5 percent. However, a sizeable share of those new jobs came from seasonal hiring by FedEx and UPS, most of whom have now been terminated. Also, the ratio of employed persons relative to the total population has barely budged off its February 2010 low, and is comparable to levels seen in the early 1980s. Despite the rise in employment, real personal income continues to fall, implying that many new jobs are low-paying. Consumers are making up for the shortfall by tapping savings and taking on more credit (which might temporarily boost 4Q GDP), but neither stopgap is sustainable in the long run.



Previous six month's behavior of macroeconomic variables indexed relative to their historical 10-year min, max and average (lower and upper ends of the orange bars, and black dots, respectively)

• Manufacturing – New factory orders rose in November and December, according to both the Census Bureau and ISM. However, at least some of those new orders appear to have been timed to beat expiring 2011 tax incentives. If companies indeed moved forward significant amounts of output, that will bode ill for 2012. Moreover, Moody's Investors Service has downgraded its outlook for the global paper and forest products industries to negative over concerns related to business conditions in the next 12 to 18 months.

• Construction – Housing starts and permits (especially for multi-family units) were on the rise in November. Despite these improvements, the housing market has a long way to go before it returns to health. Record-low mortgage rates will prove largely impotent to stimulate greater building activity until home prices bottom and foreclosures fall to more manageable numbers.

• Oil price – Iran has threatened to close the Straits of Hormuz if the European Union bans imports of Iranian crude over Iran's nuclear program. That threat has permanently embedded a $10 to $20 premium in the price of oil. Such a closure would trap a fifth of the world's oil production, sending prices much higher than the current $100/barrel.

This report is a compilation of articles posted on our website (http://delphiadvisorsmacropulse.blogspot.com/); those articles relate recent economic developments to the U.S. forest products sector in much greater detail. They also provide context for our complete, 24-month forecast, which is contained in the *Economic Outlook* newsletter available through Forest2Market (http://www.forest2market.com/f2m/us/products/outlook). ■

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