Forecast: Recovery Hopes Are Too Rosy

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By Michael Kahn

SAN FRANCISCO (Reuters) - The U.S. economy faces at least another year of tepid growth despite a growing number of predictions that a stronger recovery is around the corner, according to a forecast released on Wednesday.

The widely watched survey issued by the Anderson School at the University of California, Los Angeles said neither consumers nor businesses have the buying or investment power to drive the solid growth seen in typical economic recoveries.

While a recent spate of better-than-expected economic data has pushed growth forecasts to 4 percent or more for the second half of the year, the Anderson Forecast pegs growth at a modest 2.5 percent on average through the middle of 2004.

That forecast is far less optimistic than the emerging consensus. A panel of 35 economists at the National Association for Business Economics earlier this month raised its forecast for U.S. growth this year, citing tax cuts and very low interest rates.

"There is nothing to make you think we will have this spurt of growth," said the report's author, UCLA economist Ed Leamer. "I just don't see it."

Leamer said even though business investment is creeping back, consumers -- who have taken advantage of low interest rates to keep spending -- do not have much room left now to help spark stronger growth.

Increased debt and higher debt servicing because of rising long-term interest rates are also likely to further drag down consumer spending, the report said.

"We need an improvement of the consumer balance sheets and that takes time," Leamer said. "We are sort of stuck like we were in the early '90s with no significant driver pulling the economy forward."

Defense spending, which soared due to the war in Iraq and helped boost growth to 3.1 percent in the second quarter, will not add much to gross domestic product in the second half of the year, he said.

And tight budgets will keep a lid on spending at the state and local level and be a drag on the economy, Leamer said.

"State and local is going to contribute negatively where normally it contributes about 0.4 percent to GDP growth," Leamer said.

Leamer said the labor market will remain poor with the unemployment rate rising to 6.4 percent in 2004 from 6.1 percent in 2003. The jobless level was expected to remain above 6 percent through 2005.

"This labor market is much worse than it has ever been in terms of post-recession outcome," Leamer said. "The job market is extremely unhealthy."

Leamer said the economy will not get much more of a boost from a red-hot housing market because elevated mortgage rates will slow home buying by the end of this year.

The UCLA forecast pegged housing starts to rise slightly to 1.78 million in the third quarter before dropping to 1.56 million in the fourth quarter and 1.5 million in the first quarter of 2004.

The survey also forecast core inflation -- measured as the consumer price index minus food and fuel prices -- remaining tame at 2.1 percent in the third quarter followed by 1.5 percent at the end of the year.
