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Market Facts

The Wall Street Journal Forecasting Survey: Who Isn't Looking For Rates To Rise?

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Today the *Wall Street Journal* published its semi-annual forecasting survey of economists. The overwhelming consensus of the 55 economists surveyed was for **higher** 10-year interest rates by June 30, 2005.

As the table below shows, 98% (54 of 55) of all economists surveyed are looking for higher interest rates by the end of the year. Only David Rosenberg of Merrill Lynch is looking for 10-year yields to fall (his forecast is for 3.80% 10-year yields on June 30, 2005). This ties the (last) June 2004 survey as the most one-sided ever. Likewise, the consensus is looking for 10-year rates to increase 57 basis points

(from 4.22% on December 31 to 4.79% on June 30) – the second most aggressive forecast for higher rates since this survey began in 1982 (only the January 2003 forecast of an increase of 60 basis points was more aggressive).

Historically, this survey is good contrarian indicator. While these economists correctly predicted the direction of 10-year rates in the July 2003 and January 2004 polls, they were incorrect in looking for a rise in rates in their July 2004 poll.

The Wall Street Journal Forecasting Survey

Long-Term Interest Rate Forecasts for the Next Six Months¹

Date of Survey	Forecasted Change in Yield	Actual Change in Yield	Was the Forecast in Direction Correct?	% Of Respondents That Were Forecasting Long-Rates To Be:		
				Higher	Lower	Unchanged
Jul-95	-0.04%	-0.70%	YES	48%	52%	0%
Jan-96	0.06%	0.95%	YES	56%	42%	2%
Jul-96	-0.03%	-0.25%	YES	48%	46%	5%
Jan-97	-0.12%	0.14%	NO	30%	70%	0%
Jul-97	0.01%	-0.86%	NO	49%	51%	0%
Jan-98	0.10%	-0.28%	NO	58%	42%	0%
Jul-98	0.08%	-0.55%	NO	62%	35%	3%
Jan-99	-0.05%	0.89%	NO	37%	54%	9%
Jul-99	-0.15%	0.50%	NO	28%	67%	6%
Jan-00	-0.10%	-0.58%	YES	36%	49%	15%
Jul-00	0.11%	-0.40%	NO	64%	16%	6%
Jan-01	-0.15%	0.30%¹	NO	20%	69%	11%
Jul-01	-0.10%	-0.38%	YES	39%	59%	2%
Jan-02	0.04%	-0.22%	NO	42%	58%	0%
Jul-02	0.40%	-0.98%	NO	93%	7%	0%
Jan-03	0.60%	-0.31%	NO	95%	5%	0%
Jul-03	0.34%	0.74%	YES	87%	9%	4%
Jan-04	0.50%	0.34%	YES	96%	4%	0%
Jul-04	0.55%	-0.37%	NO	98%	2%	0%
Jan-05	0.57%	????	???	98%	2%	0%

¹ = Starting with the July 2001 survey, the benchmark interest rate changed from the 30-year bond to the 10-year note. The actual change for January 2001 reflects the change of the 30-year bond.

Source: *The Wall Street Journal*

Relating Inflation to Interest Rates

Economists consistently say interest rates are moved by both actual and *expected* inflation. The tables below show they forecasted the change in YoY CPI in 8 of the last 12 surveys correctly. Yet even with this correct forecast they cannot predict the direction of interest rates accurately; only 4 of the last 12 survey forecasts were directionally correct. Furthermore, only 3 of the last 12 surveys were directionally correct for both inflation and interest rates.

Why the difference? If they can consistently forecast inflation correctly, why are they so wrong when it comes to interest rates? We

believe factors other than inflation move interest rates. Although inflation/deflation talk is important, it is only one factor that influences the movement of 10-year interest rates.

In other words, while economists are successful in predicting inflation and economic statistics, that is only part of the equation in predicting the direction of interest rates. Many other non-economic factors must be accounted for in an interest rate forecast, such as convexity, leverage, and the stock market. These are difficult factors to predict, and help explain why the economists cannot always translate an accurate inflation forecast into an accurate interest rate forecast.

The Wall Street Journal Forecasting Survey
Inflation Forecasts (Expectations)
for the Next Six Months

Date of Survey	YoY CPI When Survey Published	YoY CPI Forecast for 6 mos. Forward	Forecast Change in Inflation	Actual Change in Inflation	Was the Forecast in Direction Correct?
Jan-99	1.61%	1.85%	0.24%	0.35%	YES
Jul-99	1.96%	1.05%	-0.91%	0.72%	NO
Jan-00	2.68%	2.50%	-0.18%	1.05%	NO
Jul-00	3.73%	3.12%	-0.61%	-0.34%	YES
Jan-01	3.39%	2.75%	-0.64%	0.23%	NO
Jul-01	3.62%	2.95%	-0.67%	-1.72%	YES
Jan-02	1.90%	1.40%	-0.50%	-0.70%	YES
Jul-02	1.20%	2.20%	1.00%	1.00%	YES
Jan-03	2.20%	2.16%	-0.04%	-0.10%	YES
Jul-03	2.10%	1.90%	-0.20%	-0.30%	YES
Jan-04	1.80%	1.90%	0.10%	1.30%	YES
Jul-04	3.10%	2.90%	-0.20%	0.10%	NO
Jan-05	3.20%	2.50%	-0.70%	???	???

Source: The Wall Street Journal

The Wall Street Journal Forecasting Survey
Long-Term Interest Rate Forecasts
for the Next Six Months¹

Date of Survey	Forecasted Change in Yield	Actual Change in Yield	Was the Forecast in Direction Correct?
Jan-99	-0.05%	0.89%	NO
Jul-99	-0.15%	0.50%	NO
Jan-00	-0.10%	-0.58%	YES
Jul-00	0.11%	-0.40%	NO
Jan-01	-0.15%	0.30%¹	NO
Jul-01	-0.10%	-0.38%	YES
Jan-02	0.04%	-0.22%	NO
Jul-02	0.40%	-0.98%	NO
Jan-03	0.60%	-0.31%	NO
Jul-03	0.34%	0.74%	YES
Jan-04	0.50%	0.34%	YES
Jul-04	0.55%	-0.37%	NO
Jan-05	0.57%	????	???

Source: The Wall Street Journal

¹ = Starting with the July 2001 survey, the benchmark interest rate changed from the 30-year bond to the 10-year note. The actual change for January 2001 reflects the change of the 30-year bond.

Conclusion

While economists are successful at predicting government statistics such as inflation, they have not been successful in predicting markets variables such as interest rates. A long-term historic sample suggests their current forecast of higher interest

rates will be wrong and lower rates will prevail between now and June 30.

The short-term sample contradicts this, however. Two of the last three surveys have been correct: Both the forecast consensus and the ultimate direction of interest rates were higher.

The Wall Street Journal Forecasting Survey

Long-Term Interest Rate Forecasts for the Next Six Months¹

Date of Survey	Yield When Survey Published	Yield Forecast for 6 mos. Forward	Forecasted Change in Yield	Actual Change in Yield	Absolute Difference between Forecast and Actual	Was the Forecast in Direction Correct?
Jan-82	13.45%	13.05%	-0.40%	0.47%	0.87%	
Jul-82	13.92%	13.27%	-0.65%	-3.51%	2.86%	YES
Jan-83	10.41%	10.07%	-0.34%	0.57%	0.91%	
Jul-83	10.98%	10.54%	-0.44%	0.89%	1.33%	
Jan-84	11.87%	11.39%	-0.48%	1.77%	2.25%	
Jul-84	13.64%	13.78%	0.14%	-2.11%	2.25%	
Jan-85	11.53%	11.56%	0.03%	-1.09%	1.12%	
Jul-85	10.44%	10.50%	0.06%	-1.17%	1.23%	
Jan-86	9.27%	9.42%	0.15%	-1.99%	2.14%	
Jul-86	7.28%	7.41%	0.13%	0.21%	0.08%	YES
Jan-87	7.49%	7.05%	-0.44%	1.01%	1.45%	
Jul-87	8.50%	8.45%	-0.05%	0.48%	0.53%	
Jan-88	8.98%	8.65%	-0.33%	-0.13%	0.20%	YES
Jul-88	8.85%	9.36%	0.51%	0.14%	0.37%	YES
Jan-89	8.99%	9.25%	0.26%	-0.95%	1.21%	
Jul-89	8.04%	8.12%	0.08%	-0.07%	0.15%	
Jan-90	7.97%	7.62%	-0.35%	0.43%	0.78%	
Jul-90	8.40%	8.16%	-0.24%	-0.16%	0.08%	YES
Jan-91	8.24%	7.65%	-0.59%	0.17%	0.76%	
Jul-91	8.41%	8.22%	-0.19%	-1.02%	0.83%	YES
Jan-92	7.39%	7.30%	-0.09%	0.39%	0.48%	
Jul-92	7.78%	7.61%	-0.17%	-0.39%	0.22%	YES
Jan-93	7.39%	7.44%	0.05%	-0.72%	0.77%	
Jul-93	6.67%	6.83%	0.16%	-0.33%	0.49%	
Jan-94	6.34%	6.26%	-0.08%	1.27%	1.35%	
Jul-94	7.61%	7.30%	-0.31%	0.26%	0.57%	
Jan-95	7.87%	7.94%	0.07%	-1.23%	1.30%	
Jul-95	6.64%	6.60%	-0.04%	-0.70%	0.66%	YES
Jan-96	5.94%	6.00%	0.06%	0.95%	0.89%	YES
Jul-96	6.89%	6.86%	-0.03%	-0.25%	0.22%	YES
Jan-97	6.64%	6.52%	-0.12%	0.14%	0.26%	
Jul-97	6.78%	6.79%	0.01%	-0.86%	0.87%	
Jan-98	5.92%	6.02%	0.10%	-0.28%	0.38%	
Jul-98	5.64%	5.72%	0.08%	-0.55%	0.63%	
Jan-99	5.09%	5.04%	-0.05%	0.89%	0.94%	
Jul-99	5.98%	5.83%	-0.15%	0.50%	0.65%	
Jan-00	6.48%	6.38%	-0.10%	-0.58%	0.48%	YES
Jul-00	5.90%	6.01%	0.11%	-0.40%	0.51%	
Jan-01	5.50%	5.35%	-0.15%	0.30%¹	0.45%	
Jul-01	5.40%	5.30%	-0.10%	-0.38%	0.28%	YES
Jan-02	5.02%	5.06%	0.04%	-0.22%	0.26%	
Jul-02	4.80%	5.20%	0.40%	-0.98%	1.38%	
Jan-03	3.82%	4.42%	0.60%	-0.31%	0.91%	
Jul-03	3.51%	3.85%	0.34%	0.74%	0.40%	YES
Jan-04	4.25%	4.75%	0.50%	0.34%	0.16%	YES
Jul-04	4.59%	5.14%	0.55%	-0.37%	0.92%	
Jan-05	4.22%	4.79%	0.57%	????	????	????
Difference Between Forecast And Actual (average of all periods)						0.82%
Batting Average						0.302

¹ = Starting with the July 2001 survey, the benchmark interest rate changed from the 30-year bond to the 10-year note. The actual change for January 2001 reflects the change of the 30-year bond.

Source: *The Wall Street Journal*

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