



V I E W P O I N T

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Improving Payrolls Leads to Upward GDP Revisions

Based on the improving trend in U.S. payrolls, the Argus Economics Department is modestly increasing its GDP estimates for 4Q11 to 3.0%. Our new forecast assumes improved growth within the Consumer sector, stronger growth in Technology spending and a decline in imports as the dollar weakens. These factors are expected to offset curtailed growth in government spending through 2012. We have also modestly increased our forecasts for 2012. Our quarterly estimates range from 2.3% to 2.9%, and average 2.6% — up from our prior average estimate of 2.3% (but still below the “normal” trend of 3.0%).

Our current estimates do not call for a recession through 2012. We believe that key indicators are showing enough positive signs to keep the economy on a growth track. However, if the European Union breaks apart or if the U.S. jobs base reverses course, the odds of a recession will increase substantially.

3Q GDP Growth Downwardly Revised

The Commerce Department, in its first revision, announced that 3Q GDP increased 2.0%, down from 2.5%. This was driven by a reduction in inventories and we anticipate inventory rebuilding in the quarters ahead. Key trends included:

- Real Personal Consumption Expenditures grew 2.4% in 3Q versus a 0.5% gain in 2Q.
- Durable goods increased an upwardly revised 5.5%, in contrast to a decrease of 5.3% in 2Q.
- Services increased 2.9%, up from 1.9%.
- Equipment & Software jumped 15.6% (down from 17.4%), compared with an increase of 6.3%.
- Real estate moved forward, with a gain of 1.6% (though down from 2.4%).

The 3Q growth rate still indicates a pick-up from the first and second quarters (please see GDP Table on Page 3). Yet while growth accelerated in 3Q11 from 1H11, the economy remains historically weak and has been in a challenging pattern since 2Q07 (see Chart 1 on Page 2).

First, the Consumer. During 3Q, Personal Consumption Expenditures accounted for 62.1% of GDP sales, and grew 2.4% (please see Chart 2). The good news included a 5.5% increase in Durable Goods and a 2.9% increase in services. This was the strongest growth in services since 2007.

The next category, Investment, showed a slowdown — to 0.9% growth in 3Q versus 6.0% growth in 2Q. The main culprit was a draw-down in inventories. We think European debt problems and U.S. credit downgrade left manufacturers reluctant to ramp-up production. Still, there were bright spots. Spending on Equipment & Software increased at a 14.9% rate. Further, low interest rates encouraged investment in Structures, which gained 12.4%.

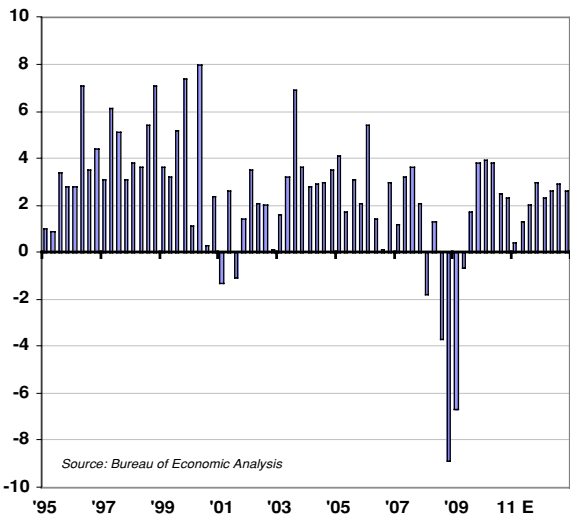
The weak dollar also had an impact on the economy. A cheaper greenback gives a pricing advantage to U.S.-produced goods and services. During 3Q, U.S. exports of goods rose 4.9% and exports of services increased 2.7%. The cheaper dollar also makes imports more expensive. Last quarter, imports of goods and services increased just 0.6%. A year ago, when consumers were more ebullient, imports of goods and services rose 12.3%.

Government spending again had a muted impact during 3Q. Efforts by Republicans to focus the debate in Washington on the nation's deficit (rather than on jobs) have paralyzed Congress and the Administration — and Federal government spending increased only 1.9%. State & Local spending declined 1.4%.

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TABLE 1

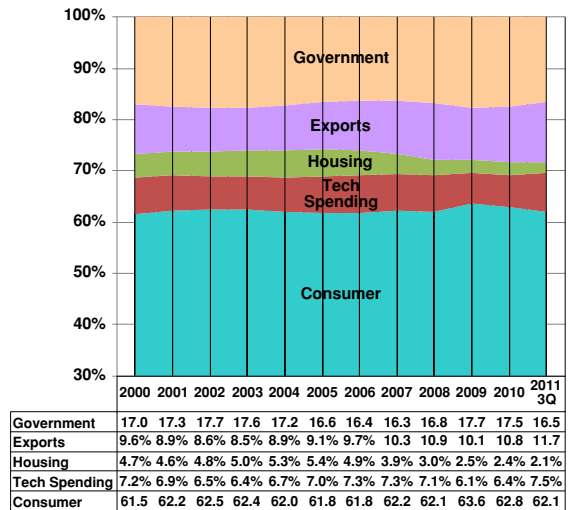
REAL GDP



We anticipate that a constrained consumer will keep U.S. economic growth below the “normal” rate of 3.0% through 2012, though our estimates are increasing.

TABLE 2

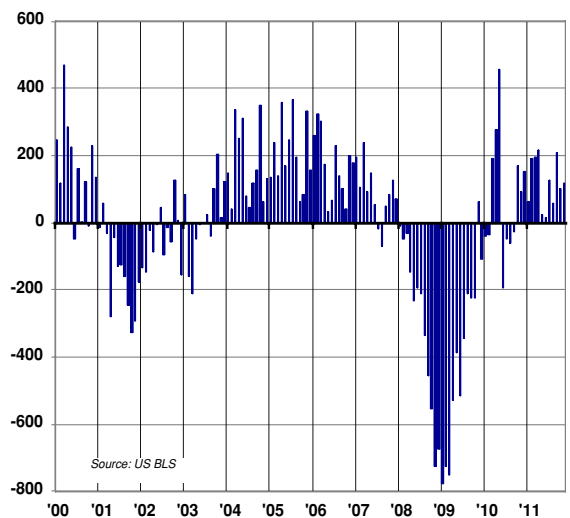
CATEGORY SHARE OF GDP



Spending on Technology has become an increasingly important element of the U.S. economy.

TABLE 3

NONFARM PAYROLLS (THOUSANDS OF JOBS)



Employment growth has accelerated from the slow summer months. Declines in weekly jobless claims point to further strength.

TABLE 4

CURRENCY TRENDS



We look for the dollar to weaken into 2012, based on Washington’s spending habits. A lower dollar makes U.S. goods more competitive in global markets.

GDP FORECAST

Revised as of October 28, 2011

	2009 A				2010				2011 E				2012 E			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Real Gross Domestic Product	-6.7	-0.7	1.7	3.8	3.9	3.8	2.5	2.3	0.4	1.3	2.0	3.0	2.3	2.6	2.9	2.6
Annual:				-0.5				3.1				1.7				2.6
Personal Consumption	0.6	-0.9	2.2	1.9	1.9	2.8	2.8	3.9	2.4	0.5	2.4	2.0	0.9	0.7	1.3	0.8
Goods	2.5	-3.1	7.2	2.9	5.7	3.4	5.1	8.9	5.3	-1.9	1.6	2.7	1.1	0.9	1.8	1.2
Durables	3.9	-5.6	20.4	0.4	8.8	7.8	8.8	17.2	11.8	-5.3	5.5	4.0	1.7	1.6	3.1	1.5
Non-Durables	1.9	-1.9	0.0	5.6	4.2	1.9	3.0	4.3	1.6	0.2	-0.7	2.0	0.8	0.5	1.0	1.0
Services	-0.3	0.2	0.8	1.0	0.1	2.5	1.6	1.3	0.8	1.9	2.9	1.6	0.7	0.7	1.0	0.6
Gross Domestic Investment	-50.5	-23.7	-7.0	66.1	29.1	26.8	9.0	-5.3	4.5	6.0	0.9	5.4	1.5	2.9	6.8	4.5
Fixed Investment	-39.0	-12.5	-14.4	20.2	3.3	22.8	2.4	7.4	2.0	8.6	12.4	3.4	0.4	2.9	6.9	4.6
Non-Residential	-39.2	-9.6	-8.5	6.7	7.8	21.9	11.8	8.6	3.0	9.7	14.9	3.9	0.5	3.0	8.5	5.6
Structures	-43.6	-17.3	-18.4	-18.1	-17.8	7.4	4.2	10.6	-14.4	22.6	12.6	4.6	0.5	1.2	1.2	1.2
Equip. & Software	-36.4	-4.9	1.5	19.0	20.4	23.2	14.2	8.0	8.7	6.3	15.6	3.7	0.5	3.5	10.7	6.8
Residential	-38.2	-23.2	18.9	3.7	-12.3	22.8	-27.7	2.5	-2.5	4.2	1.6	1.4	0.3	2.8	0.0	0.0
Change in Pvt. Inventories (\$BIL)	-113.9	-160.2	-139.2	-19.7	44.1	68.8	92.3	38.3	48.1	39.1	-8.5	0.0	20.0	20.0	20.0	20.0
Net Exports																
Exports	-29.9	-4.1	8.4	-2.5	11.4	10.0	10.0	7.8	7.9	3.6	4.3	1.2	1.0	-0.2	-0.2	1.8
Goods	-36.9	-6.3	17.5	23.1	14.0	11.8	9.0	9.2	10.6	2.5	4.9	0.6	1.1	-0.7	-0.7	0.9
Services	-13.6	0.2	24.6	34.1	5.8	6.1	12.5	4.7	1.7	6.2	2.7	2.5	0.8	1.1	1.1	3.8
Imports	-36.4	-14.7	5.6	2.7	11.2	21.7	12.3	-2.3	8.3	1.4	0.6	2.6	0.2	-8.8	-8.8	-7.2
Goods	-41.0	-16.5	21.2	16.1	12.0	26.0	12.4	-0.5	9.6	1.5	0.3	2.8	0.3	-9.4	-9.4	-8.6
Services	-11.5	-7.5	25.1	20.6	7.8	3.2	11.6	-10.4	2.2	0.4	2.0	1.7	-0.3	-5.4	-5.4	0.0
Gov't Purch. of Goods & Svcs.	-2.6	6.7	3.2	-1.3	-1.6	3.8	1.0	-2.8	-5.9	-0.9	0.0	0.8	1.3	0.8	0.6	0.3
Federal	-4.3	11.4	7.9	0.1	1.8	8.8	3.1	-3.0	-9.4	1.9	1.9	2.9	2.4	1.9	1.5	0.7
National Defense	-5.1	14.0	8.4	-3.6	0.4	6.0	5.7	-5.9	-12.6	7.0	4.7	0.5	1.1	1.7	1.1	0.0
Non-Defense	-2.4	6.1	7.0	8.3	5.0	14.6	-1.8	3.0	-2.7	-7.6	-3.7	7.8	4.9	2.2	2.2	2.2
State & Local	-1.6	3.9	-0.6	-2.2	-3.8	0.4	-0.5	-2.7	-3.3	-2.8	-1.4	-0.7	0.4	0.0	0.0	0.0
Addendum:																
GDP Price Deflator (implicit)	1.0	0.3	0.7	-0.3	1.1	1.6	1.6	1.9	1.8	2.0	2.1	2.1	1.8	2.0	2.0	2.0

(continued from page 1)

Looking Ahead: Boosting Our Outlook

Previously, we anticipated below-trend growth of 1.9% in 2012 — but we are now expecting the economy to advance an average 2.6%. Here are our key assumptions:

- We look for an improving jobs situation to allow for modest growth in Personal Consumption Expenditures, though not at a robust pace.
- As companies continue to refrain from hiring, we anticipate that spending on Equipment & Software, which drives productivity, will grow at a 5%-8% rate.
- The current low inventory-to-sales ratio implies that companies will resume investing in inventories, and that the Industrial sector will continue to grow.
- The \$320 billion U.S. housing industry has been flat to higher in recent quarters (despite the headlines), and we expect stability (if not 1%-2% growth) into next year.
- Though the dollar is currently strengthening amid the crisis fears in Europe, we anticipate that dismal financial condition of the U.S. government should reverse the trend in 2012, sending the greenback lower and making U.S. goods, including commodities, more attractively priced in global markets (please see Chart 4). We anticipate mid-single-digit growth (on average) in exports over the next three to four quarters, as foreign economies continue to grow.
- Federal government spending rose at a 1.9% pace in 2Q, after having declined for the previous two quarters. Heading into an election year, we anticipate low-single-digit growth.
- State & Local government spending declined 1.4% in 3Q, and has fallen in seven of the past eight quarters. This is an important component of the economy (particularly in the early quarters after a recession) that has been — and will likely remain — missing in action.

Positive Signals

We see enough positive momentum in the U.S. economy to conclude that recession can be avoided. Here are some of the factors we are following:

- **Federal Reserve activity.** The Fed is moving forward with its Operation Twist program, through which it is selling short-term paper and buying \$400 billion in long-term Treasuries (this in an attempt to keep long-term interest rates low and spur investment). Proceeds from sales of

mortgage-related securities will be reinvested in MBS, helping to keep mortgage rates low. The housing market remains the weakest factor in U.S. GDP. Given the shadow inventory of foreclosed homes on bank balance sheets, we estimate that the housing industry will remain under pressure for the next three years.

- **Unemployment Claims.** A year ago, claims averaged 453,000 per week and were rising. However, claims recently have been below 400,000. While the current level of claims is still higher than we would like to see, we think it is consistent with jobs growth (on average) of 75,000-125,000 per month. We estimate that jobs growth of 150,000 in a month will lower the unemployment rate by 0.1%.
- **Retail sales.** The preliminary retail store sales tally for the Thanksgiving weekend showed a 16.4% surge to a record \$52.4 billion. Store traffic, including internet touches, jumped 6.6% to 226 million, also a record. The surprise in store sales has extended the recovery in total (Dept. of Commerce) retail spending that began in early September.

Risks of Recession

There are risks that our forecasts may be too optimistic.

While we don't normally pay much attention to consumer confidence surveys (we prefer the hard data from the government on sales, or better yet the same-store sales figures from the companies themselves), the surveys of business leaders are important because businesses have the ability to create jobs. Recently, the ISM Index, which is a measure of business confidence, has been hovering at the break-even level between growth and recession. If the economy's jobs base starts to shrink, the odds of a recession will become much higher.

The political climate in Washington is another factor that could derail economic growth. The Congressional Super Committee of budget-cutters punted their responsibility, missing a chance to take decisive action on government debt. As a matter of fact, given an almost-no-growth economy, we think the government's focus should be on creating jobs in the near term, not on reducing spending growth 3-5 years down the road.

The ongoing debate in Washington also has additional implications for the economy. The recent S&P credit rating downgrade hasn't yet led to higher interest rates for the U.S. government or for most corporations. But the downgrade has raised questions and sapped confidence from purchasing managers and consumers in the market for big-ticket items (such as homes). This confidence will need to be restored if there is to be a lift in economic growth rates back to normal.

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