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U.S. Skirts Past Recession, For Now

Based on the stronger-than-anticipated initial reading on 3Q economic activity, the Argus Economics Department is now modestly increasing its GDP estimates for 4Q11 and 1H12. Our new forecasts assume 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. Our new forecasts for this upcoming period range from 2.0% to 2.6%, and average 2.3% — up from our prior average estimate of 1.9% (but still well below the "normal" U.S. GDP growth-rate trend of 3.0%).

Our current estimates still 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 U.S. jobs base begins to contract, the odds of a recession will increase substantially.

3Q GDP Shows Growth

The Commerce Department announced that 3Q GDP increased 2.5%, and the increase was broad-based:

- Real Personal Consumption Expenditures, the most-important component of GDP, grew 2.4% in 3Q versus a 0.7% gain in 2Q.
- Durable goods increased 4.1%, in contrast to a decrease of 5.3% in 2Q.
- Services increased 3.0%, up from 1.9%.
- Technology spending also advanced. Equipment & Software jumped 17.4%, compared with an increase of 6.2%.
- Even real estate moved forward, with a gain of 2.4%.

The 3Q growth rate indicates a solid pick-up from the first and second quarters, during which the U.S. economy advanced at an average rate of 0.8% (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 (Chart 1 on Page 2).

Let's take a closer look at the underlying trends. First the Consumer. During 3Q, Personal Consumption Expenditures accounted for 70.7% of total GDP, and posted 2.4%. The good news included a 4.1% increase in Durable Goods and (even better) a 3% increase in services. This was the strongest growth in services since 2007.

The next category, Investment, cooled off a bit — to 4.1% growth in 3Q versus 6.4% growth in 2Q. We think the European debt problems and U.S. credit downgrade may have had an impact on corporate confidence and decision-making during the latest period. Still, there were bright spots. For example, spending on Equipment & Software increased at a 17.4% rate. Further, low interest rates encouraged investment in Structures, which gained 13.3%. However, inventory building was weak, adding only $5 billion to GDP.

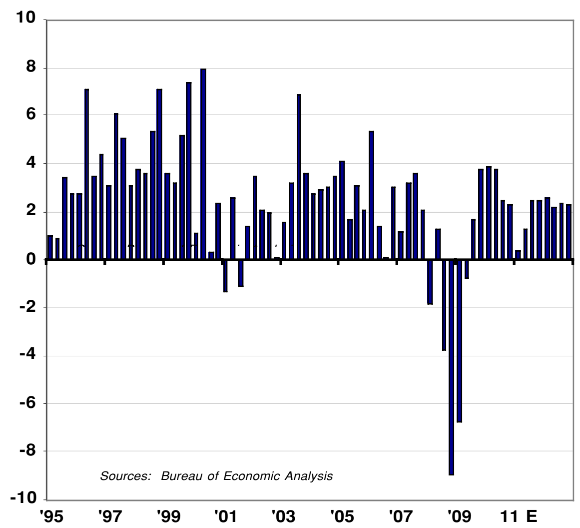
The weak dollar also had an impact on the economy. A cheaper greenback gives a pricing advantage to U.S.-produced goods and services. During 3Q, U.S. exports of goods rose 4.7% and exports of services increased 2.4%. The cheaper dollar also makes imports more expensive. Last quarter, imports of goods and services increased just 1.9%. 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, has paralyzed Congress and the Administration — and Federal government spending increased only 2.0%. State & Local spending declined 1.3%.

(continued on back page)

TABLE 1

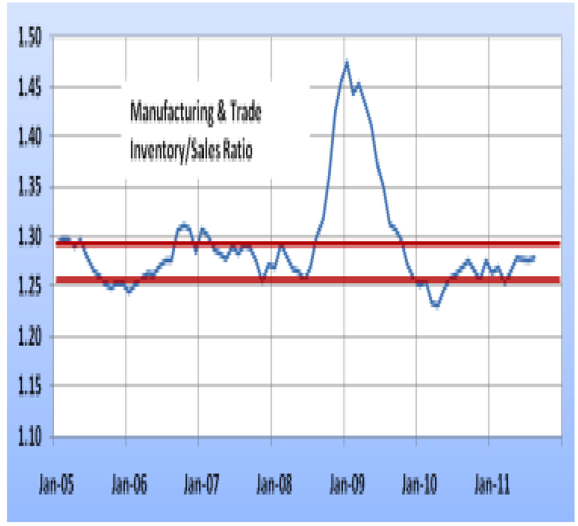
REAL GDP



We anticipate that a constrained consumer will keep U.S. economic growth well below the "normal" rate of 3.0% through 2012.

TABLE 2

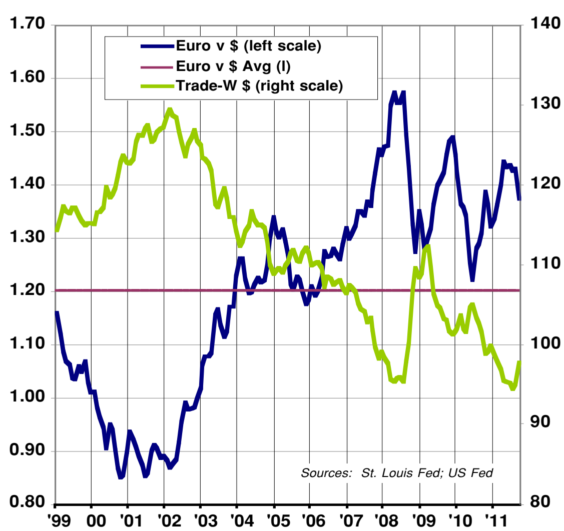
INVENTORY/SALES RATIO



An historically low inventory-to-sales ratio suggests that companies may invest in inventories during the quarters ahead.

TABLE 3

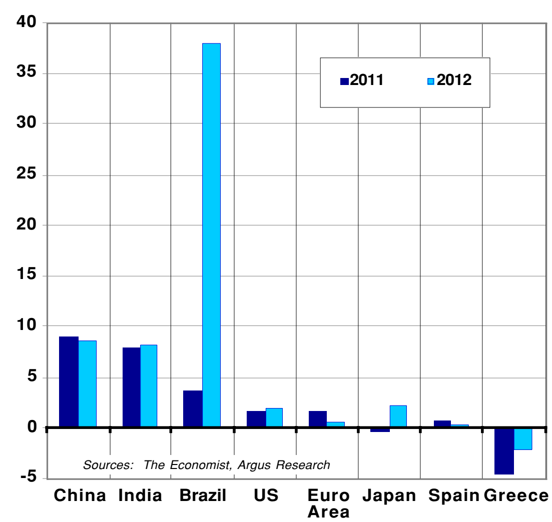
CURRENCY TRENDS



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.

TABLE 4

GLOBAL GDP FORECAST
(RATES OF Y/Y GROWTH)



We look for global growth to remain steady for most trading partners, though Europe will likely lag as the euro nations work to resolve their sovereign-debt problems.

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**	**2.5**	**2.5**	**2.5**	**2.3**	**2.5**	**2.3**
Annual:				-0.5				**3.1**				**1.7**				**2.4**
Personal Consumption	0.6	-0.9	2.2	1.9	**1.9**	**2.8**	**2.8**	3.9	**2.4**	**0.5**	**2.5**	**1.9**	**5.5**	**-2.0**	**0.8**	**1.1**
Goods	2.5	-3.1	7.2	2.9	**5.7**	**3.4**	**5.1**	8.9	**5.3**	**-1.9**	**1.7**	**2.7**	**3.2**	**0.4**	**0.9**	**1.8**
Durables	3.9	-5.6	20.4	0.4	**8.8**	**7.8**	**8.8**	17.2	**11.8**	**-5.3**	**4.1**	**5.0**	**4.0**	**0.6**	**0.9**	**3.1**
Non-Durables	1.9	-1.9	0.0	5.6	**4.2**	**1.9**	**3.0**	4.3	**1.6**	**0.2**	**0.2**	**1.3**	**2.6**	**0.2**	**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**	**3.0**	**1.5**	**6.9**	**-3.2**	**0.7**	**0.7**
Gross Domestic Investment	-50.5	-23.7	-7.0	66.1	**29.1**	**26.8**	**9.0**	**-5.3**	**4.5**	**6.0**	**5.6**	**1.2**	**5.8**	**2.8**	**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**	**14.0**	**2.4**	**6.5**	**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**	**16.7**	**2.7**	**7.5**	**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**	**14.4**	**3.4**	**10.2**	**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**	**17.4**	**2.5**	**6.7**	**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**	**2.4**	**0.8**	**2.1**	**2.5**	**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**	**49.1**	**39.1**	**5.4**	**0.0**	**40.0**	**40.0**	**40.0**	**40.0**
Net Exports																
Exports	-29.9	-4.1	8.4	-2.5	**11.4**	**10.0**	**10.0**	**7.8**	**7.9**	**3.6**	**4.0**	**1.4**	**1.0**	**-0.1**	**-0.1**	**1.8**
Goods	-36.9	-6.3	17.5	23.1	**14.0**	**11.8**	**9.0**	**9.2**	**10.6**	**2.5**	**4.7**	**0.8**	**1.1**	**-0.6**	**-0.6**	**0.9**
Services	-13.6	0.2	24.6	34.1	**5.8**	**6.1**	**12.5**	**4.7**	**1.7**	**6.2**	**2.4**	**2.8**	**0.8**	**1.2**	**1.2**	**3.8**
Imports	-36.4	-14.7	5.6	2.7	**11.2**	**21.7**	**12.3**	**-2.3**	**8.3**	**1.4**	**1.9**	**1.6**	**0.1**	**-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**	**1.8**	**1.6**	**0.2**	**-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**	**2.5**	**1.4**	**-0.4**	**-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**	**0.7**	**1.2**	**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**	**2.8**	**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**	**4.8**	**0.4**	**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**	**-1.3**	**-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

Based on recent trends in consumer spending and corporate investment, we have modestly increased our estimates for 3Q11 and 1H12 (see Chart 1). Previously, we had anticipated below-trend growth of 1.9% — but we are now expecting the economy to advance an average 2.3%.

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. This component of GPD accounts for almost 70% of the economy. Our estimates call for growth of 1.5%-2.5% through 2H11. Our jobs model forecasts that unemployment will remain in the 8.8%-9.0% range through year-end, absent a new stimulus program.
- As companies continue to refrain from hiring, we anticipate that spending on Equipment & Software, which drives productivity, will grow at a 5%-8% rate.
- A low sales-to-inventory ratio (Please see Chart 2) implies that companies will continue to invest in inventories, and that the Industrial sector will continue to grow. We anticipate that this will provide a boost to the economy in each of the next four quarters, though we are not modeling rapid growth in inventories.
- 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.
- A weak dollar — courtesy of the dismal financial condition of the U.S. government — should make U.S. goods, including commodities, more attractively priced in global markets (see Chart 3). We anticipate mid-single-digit growth on average in exports over the next three to four quarters, as foreign economies continue to grow (see Chart 4).
- 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 — despite the heated rhetoric from both parties about spending cuts.
- State & Local government spending declined 1.3% 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 proceeding 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.
- Unemployment Claims. A year ago, claims averaged 453,000 per week and were rising. However, claims were recently 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%.
- Gasoline Prices. Concerns over global economic growth have reduced the price per barrel of West Texas Intermediate crude from above $100 during the summer to the $80-$90 range. Savings from fuel costs may well show up in holiday retail spending, which we expect to advance at a 2.5%-3.5% rate.

Risks of Recession

At the same time, of course, 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. If the economy's jobs base starts to shrink, the odds of a recession will become much higher.

The politicians in Washington are also a factor that could derail economic growth. The Congressional SuperCommittee of budget-cutters is due to get back to work this month, but we are concerned that their efforts may be poorly timed. 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 sapped confidence from purchasing managers and consumers. This confidence will need to be restored to lift economic growth rates back to normal.