



# V I E W P O I N T

## THE ECONOMY

June / 2011  
Vol. 78, No. 82

### 1Q GDP Growth Still Below Trend

The Commerce Department issued its second estimate for 1Q GDP, which, at 1.8%, was unchanged from the first estimate. This compares unfavorably to the 3.1% pace recorded in 4Q, but is in line with recent expectations of weakness given the impact of recent bad weather on consumer spending.

Here are some key underlying trends:

- Personal consumption expenditures (PCE) rose at a 2.2% pace in 1Q. This was revised downward from an initial 2.7% rate and is well below the 4.0% pace in 4Q.
- Investment in equipment and software increased a strong 11.6%, as the tech expansion continued.
- Real exports increased 9.2% (upwardly revised from 4.9%), benefitting from the weak dollar.
- On the negative side, imports increased 7.5% (up from a first reading of 4.5%), driven by the rising price of oil. Government spending – at both the federal and state levels – was sharply lower.

Though the consumer trend is a bit worrisome, we still see solid underlying fundamentals for the economy, and expect that subsequent growth rates in 2011 will fall in the more-normal 2.5%-3.5% range.

### (Short) Pause in Industrial Recovery

After almost two years of solid growth, the metrics we follow for the Industrial sector have cooled off slightly in recent months.

For example, capacity utilization was down a tick last month at 76.9%, though the gauge of the Industrial sector remains well above its recessionary lows of 68.2% in May 2009. Industrial Production has now been steady for two months at 93.1 — but still much higher than the reading of 83.5 in June 2009.

We are not surprised to see a temporary pause, given the steep recovery. In our view, the overall economic recovery remains intact — driven by export growth and a revival in the Consumer sector based on an improvement in the jobs picture. These two metrics still have substantial ground to cover before reaching pre-recession highs of 100+ for Industrial Production and 80% for Capacity Utilization.

The most forward-looking metric, the survey of Purchasing Managers, is still providing very positive readings above 60. Further, the low level of the sales/inventory ratio suggests that companies will be building stockpiles over the next few quarters.

### Positive Payrolls Report

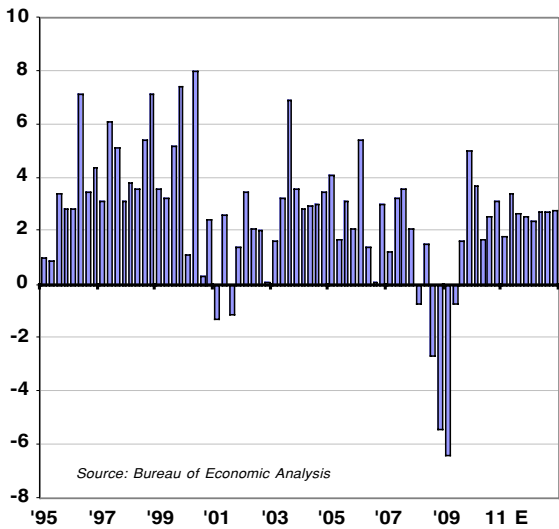
The U.S. economy continued its recent trend of solid jobs growth in April.

The economy added 244,000 jobs in the month, ahead of our forecast of 180,000. In addition, the government upwardly revised the February and March reports — adding another 46,000 payrolls to the total. The unemployment rate rose to 9%, as more workers entered the workforce. There was little change in average workweek or average hourly earnings. Over the past year, the

*(continued on back page)*

TABLE 1

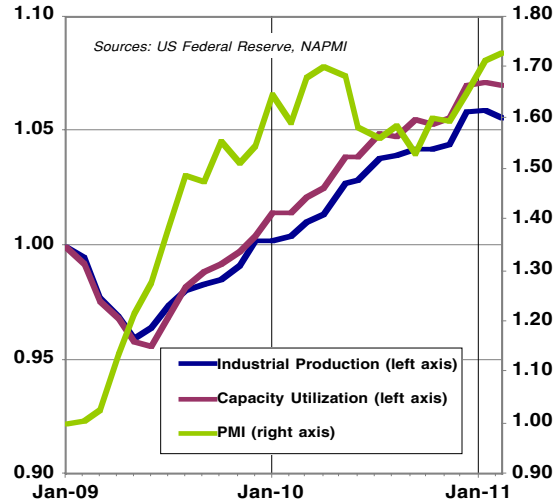
**REAL GDP**



We still see solid underlying fundamentals for the economy, and expect that subsequent growth rates in 2011 will fall in the more-normal 2.5%-3.5% range.

TABLE 2

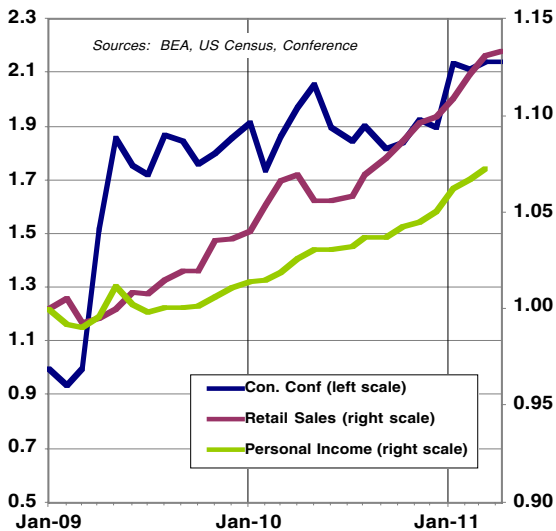
**INDUSTRIAL SECTOR METRICS  
(INDEX 1/09 = 1.00)**



The metrics we follow for the Industrial sector have cooled off slightly in recent months.

TABLE 3

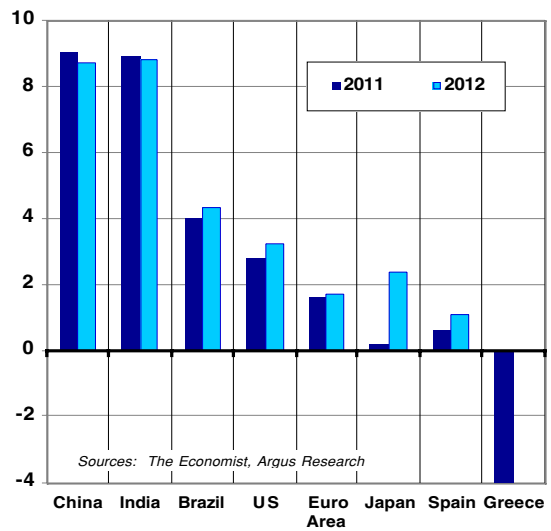
**CONSUMER TRENDS  
(INDEX 1/09 = 1.0)**



The latest Nonfarm Payrolls report, as well as ADP data and inventory trends, suggest that the economy may be moving to a more-promising phase of payrolls growth.

TABLE 4

**GLOBAL GDP FORECAST  
(RATES OF Y/Y GROWTH)**



We look for export-driven growth in emerging economies to remain elevated in 2011-2012.

**GDP FORECAST**

Revised as of May 27, 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	-4.9	-0.7	1.6	5.0	3.7	1.7	2.6	3.1	1.7	3.3	2.9	3.0	2.9	3.1	3.0	3.0
Annual:				0.3			2.8					2.7				
Personal Consumption	0.6	-0.9	2.2	1.9	1.9	2.3	2.5	4.4	2.3	2.0	2.3	1.9	6.2	1.2	1.5	1.5
Goods	2.5	-3.1	7.2	2.9	5.7	3.3	4.3	10.1	3.9	1.6	4.2	2.4	4.9	1.5	2.4	2.9
Durables	3.9	-5.6	20.4	0.4	8.8	6.8	7.6	21.1	8.9	1.9	6.4	3.1	5.9	0.9	3.1	4.7
Non-Durables	1.9	-1.9	0.0	5.6	4.2	1.9	2.5	4.1	1.1	1.4	2.9	1.9	4.3	1.9	1.9	1.9
Services	-0.3	0.2	0.8	1.0	0.1	1.6	1.6	1.5	1.5	2.2	1.3	1.6	6.9	1.0	1.0	0.6
Gross Domestic Investment	-50.5	-23.7	-7.0	66.1	29.1	24.1	14.4	-15.6	11.7	-1.3	7.0	8.3	5.6	7.9	5.6	6.4
Fixed Investment	-39.0	-12.5	-14.4	20.2	3.3	35.5	2.0	6.9	3.1	0.3	6.0	8.5	7.0	5.8	5.8	6.5
Non-Residential	-39.2	-9.6	-8.5	6.7	7.8	18.2	10.8	7.7	4.6	0.7	7.1	9.9	6.8	6.7	6.5	6.4
Structures	-43.6	-17.3	-18.4	-18.1	-17.8	-0.5	-3.6	7.7	-16.8	3.4	13.5	13.1	17.1	5.7	5.6	5.5
Equip. & Software	-36.4	-4.9	1.5	19.0	20.4	24.8	15.4	7.7	11.6	-0.1	5.4	9.0	3.9	7.0	6.8	6.7
Residential	-38.2	-23.2	18.9	3.7	-12.3	25.6	-27.3	3.3	-3.3	-1.5	1.2	2.5	8.3	2.3	2.3	7.0
Change in Pvt. Inventories	-113.9	-160.2	-139.2	-19.7	44.1	68.8	121.4	16.2	52.2	45.0	50.0	50.0	30.0	40.0	40.0	40.0
Net Exports	-29.9	-4.1	8.4	-2.5	11.4	9.2	6.7	9.2	-0.7	1.1	1.1	2.3	14.9	6.8	6.8	4.4
Exports	-36.9	-6.3	17.5	23.1	14.0	11.5	5.9	13.2	-1.6	0.0	0.0	0.0	0.0	6.6	6.6	3.2
Goods	-13.6	0.2	24.6	34.1	5.8	3.9	8.9	0.0	1.6	4.0	4.0	8.0	58.5	7.2	7.2	7.1
Services	-36.4	-14.7	5.6	2.7	11.2	33.5	16.8	7.3	0.6	0.0	0.0	0.0	3.4	-7.2	-7.2	0.0
Imports	-41.0	-16.5	21.2	16.1	12.0	40.5	17.4	9.3	0.7	0.0	0.0	0.0	0.7	-8.6	-8.6	0.0
Goods	-11.5	-7.5	25.1	20.6	7.8	4.4	14.3	-1.8	0.2	0.0	0.0	0.0	18.3	0.0	0.0	0.0
Services	-2.6	6.7	3.2	-1.3	-1.6	4.1	4.0	-1.6	-5.2	0.7	0.1	1.6	5.7	0.8	1.5	1.9
Gov't Purch of Goods & Svcs.	-4.3	11.4	7.9	0.1	1.8	9.1	8.8	-0.3	-7.9	1.7	0.3	3.9	3.9	2.0	3.6	4.6
Federal	-5.1	14.0	8.4	-3.6	0.4	7.4	8.5	-2.2	-11.7	2.6	0.0	0.0	11.6	1.1	1.7	1.1
National Defense	-2.4	6.1	7.0	8.3	5.0	12.8	9.5	3.7	0.1	0.0	0.8	11.7	-9.8	3.8	7.7	11.7
Non-Defense	-1.6	3.9	-0.6	-2.2	-3.8	0.6	0.7	-2.6	-3.2	0.0	0.0	0.0	6.9	0.0	0.0	0.0
State & Local																
Addendum:																
GDP Price Deflator (implicit)	1.0	0.3	0.7	-0.3	1.1	1.6	1.8	1.9	1.8	2.0	2.1	2.1	1.8	2.0	2.0	2.0

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economy has generated an average 109,000 jobs per month; over the past six months, the figure is 168,000.

The primary sectors adding to jobs in April were Retail, Business Services, Healthcare and Leisure & Hospitality. Governments cut from their payrolls.

This latest report, as well as ADP data and inventory trends, suggest that the economy may be moving to a more-promising phase of payrolls growth. We expect to see the unemployment rate fall toward 8.5% in 2011. If housing starts pick up, the rate may fall further.

### **Global Growth Appears Robust**

We look for export-driven growth in emerging economies to remain elevated in 2011-2012, and for these nations to far outpace growth of the mature, industrial economies.

Estimated growth rates for the BRIC nations (Brazil, Russia, India and China) are, on average, 6.5% and are stable.

We note that inverted yield curves in India and China may dampen growth by up to 50 bps.

Even so, the estimated growth rate for the U.S., UK, Euro area and Japan in 2011 is, on average, 1.8%. Forecasts for Japan have been declining because of the earthquake, though a rapid recovery is expected in 2012.

The commodity based BRAC nations (Brazil, Russia, Australia and Canada) are forecast to grow an above-trend 3.6%, benefitting from natural-resource exposure and an expected weakened dollar.

In Europe, Northern countries appear better positioned to grow than the Southern countries, as they benefit from a Euro currency that we expect to be under pressure. Estimates continue to fall for Greece, which is now expected to endure a two-year recession.

Overall, we favor BRAC and the nations surrounding China (particularly in South East Asia) as we do not think Chinese monetary programs will restrain the economy for long.

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