

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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Ending The Year On A Strong Note

The economy is ending the year on a very strong note and I believe this momentum will continue well into 2011. Given the data out the last several days, I'm looking at GDP growth to be 3.2% this quarter--- and even that may be too conservative. As I have said before, the greatest risk to this expansion is a spike in yields on government notes and bonds next year, especially if the benchmark 10-yr. treasury crosses into the 5% range during the first quarter. That will happen IF investors become increasingly skeptical of the Fed's ability to pull back in a timely manner much of the liquidity it has pumped into the financial system. For now, though, we should celebrate the improving vitality of the economy and hope this gets translated into much faster job growth in 2011.

Among the key data points out today were first time claims for jobless benefits. For the week ending December 18, the number of people applying for unemployment benefits fell 3,000 to 420,000, the second lowest number of the year. Moreover, the total number of Americans collecting unemployment insurance dropped to a two-year low.

The figures clearly show that with demand for goods and services increasing, employers have far less justification to cut their payrolls.

Consumers are on a roll

The growing increase in demand is coming from both consumers and businesses. The government's personal income and spending report showed that consumer expenditures rose at a 0.4% rate in November, marking the fifth consecutive month Americans have ramped up spending. Helping to finance that shopping was a 0.3% rise in personal income, which matched the increase seen in October.

The rise in employment and in overtime pay has lifted wages over the year, in both nominal and real terms. Disposable personal income (or take home pay) rose 3.4% in the last 12 months. If you adjust for inflation, real DPI increased 2.4% since November 2009. With Americans acquiring more purchasing power and the outlook for jobs improving, consumer spending is expected to become a major contributor to growth next year.

Indeed, Americans have become so confident about the economy and their finances, they are setting aside fewer savings. News today from the University of Michigan showed that consumer confidence rose in December to 74.5, its highest level since June. It stood at 71.4 in November. The result: the personal savings rate has now slipped from 8.2% in May of 2009 to 5.3% last month. The amount saved out of monthly income in November fell to a \$614.8 billion rate, the lowest since last March (when Americans had to dig deep to pay their income taxes).

The overall improvement in confidence was also reflected in the sale of new homes, which rose 5.5% to a 290,000 annual rate in November. The median price of a new home sold rebounded 8% last month, to \$213,000. (Yesterday, we got word that existing home sales jumped by similar percentage, 5.6%, in November, with the median price up 0.4% from October.)

There was also good news on the inventory front as well. The total stock of unsold new homes fell to 197,000, the smallest in nearly half a century! With the economy, and more specifically jobs, looking better in 2011, we expect to see builders break ground at nearly double the pace seen in 2010.

A rise in business orders will stimulate future production

Demand from the business sector has also been robust. Orders for durable goods jumped 2.4% in November if you remove the wildly volatile transportation component. (Civilian aircraft orders, for example, plummeted 53.1% in the month, which depressed headline orders for durable goods down to a minus 1.3%)

Orders for just civilian capital goods jumped 2.6%. A recent batch of surveys that span different industries (e.g., National Federation of Independent Business and the Business Roundtable) shows companies are sufficiently optimistic about the future that they plan to increase capital spending in 2011.

Bottom line:

This is not a recovery any longer. The economy has graduated into the expansion phase now that its size has exceeded its previous peak in the fourth quarter of 2007.

Once you enter the expansion phase, companies typically increase the pace of hiring. This could well mean the Fed's QE 2 will (hopefully) come to a screeching halt in the coming weeks. If so, it will keep market rates low and enable the economy to stay on its growth track.

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