

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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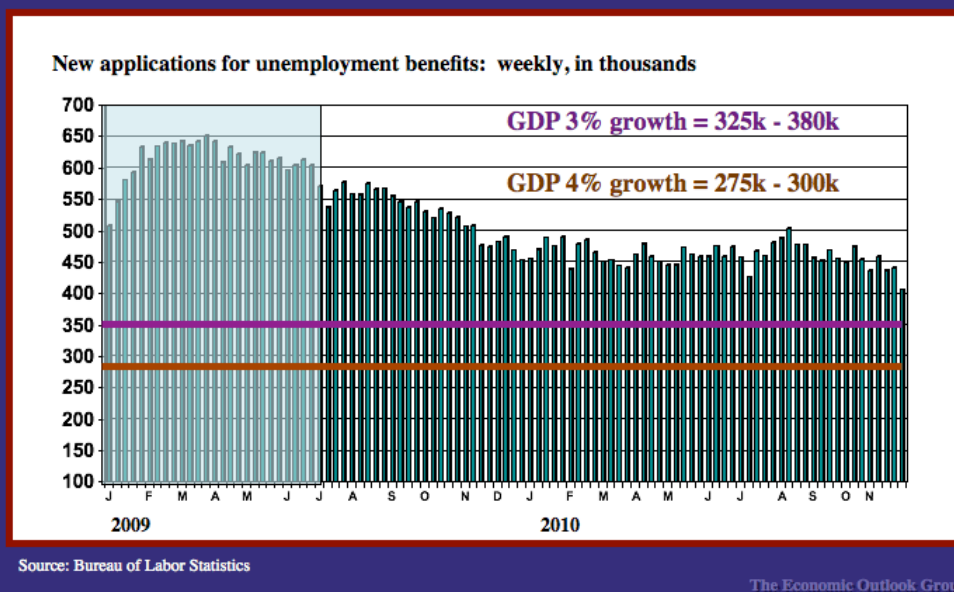
Finally, A Thanksgiving With An Economy Moving In The Right Direction

Follow the data we have always urged clients. It makes no difference whether you are a money manager, a factory supervisor or a legislator, you have to be data driven to better anticipate where the economy is headed. If you are data driven, then the last few days should provide the clearest mosaic yet that the economic recovery is not just firmly in place but that growth itself is accelerating.

Weekly Claims for Unemployment Insurance

We begin with the most promising data point, which is the latest tally on initial claims for unemployment benefits. New applications for jobless benefits plummeted by 34,000 in the week ending November 20th, to 407,000, the fewest filings since July 2008. This continues the declining trend we have observed since mid-summer. The latest figure turned out to be far below consensus expectations, which, once again, is indicative of how forecasters keep underestimating the economy's strength.

Pace of layoffs are declining...but ever so slowly

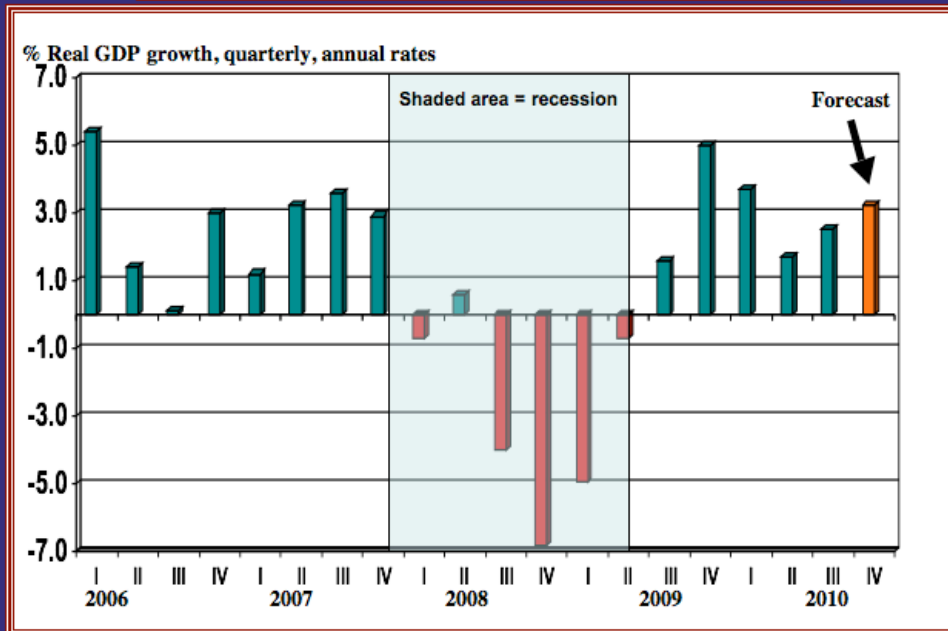


The less volatile four-week moving average also dropped, this time to 436,000 from 443,500. The total number of Americans now collecting unemployment insurance fell to 4.18 million, from 4.32 million. Even those who used up all their traditional jobless benefits and are now left to receive only emergency and extended compensation have dropped in numbers, to 4.66 million from 4.92 million.

The weekly claims report is one of several closely followed barometers showing that labor market conditions are improving, though not with enough speed to bring down the unemployment rate. However, the trend is certainly encouraging. Just yesterday, the Labor Department reported that payrolls increased in 41 states last month, the largest we have seen since last May. Only six states reported declines and three registered no change. Moreover, the ISM employment indices for both manufacturing and services showed that companies hired in greater numbers in October.

As economic activity accelerates, firms that were planning to layoff workers are reconsidering whether dismissing employees is a wise move now that business conditions keep improving. Third quarter GDP growth came in a better than expected 2.5%, with corporate profits surging to a record high \$1.66 trillion annual rate. We're forecasting GDP growth to exceed 3% this quarter, and average 3.4% in 2011. At that pace, we expect to see weekly claims for jobless insurance finally drop below 400,000 (a level last reached in July 2008) in either December or January. By our analysis, claims should fall to a range of 325k to 380k a week once the economy is able to grow at a sustained pace of a 3% to 3.5%.

Economic growth is re-accelerating; Pace of hiring will now pick up as well



Personal Income and Spending

The overall improvement in the labor market has also eased household concerns about job security and future income growth. That was clearly manifest by how willing Americans are ready to shop again. The government reported this morning that personal spending accelerated in October to 0.4%, after rising 0.3% the previous month. This is the fourth consecutive month that Americans have ramped up spending. It's no mystery why. As more people return to work, wages and salaries have increased too. Such compensation climbed nearly 0.6% in October, the biggest increase in five months. Overall, personal income leaped by 0.5% last month, after no gain in September.

But there are several other positive important data points worth noting in this report. First, with inflation virtually non-existent, a 0.5% jump in personal income increases household purchasing power. In fact, even if you adjust for both inflation and taxes, real disposable personal income last month was 2.5% above its year ago level, the best annual gain we have seen since June 2008!

Second, the brighter job outlook and the rise in real pay have allowed Americans to unleash more of the pent-up demand built up during the recession. For example, purchases of durable goods, which tend to be pricey items and often financed with credit, rose 1.9% last month, the best showing since last March. The jump in durable goods purchases by Americans tells us that they likely increased their credit card debt in October for the first time in 25 months. (We'll get the official report on October consumer credit from the Federal Reserve early in December.) This is not to suggest

shoppers are returning to the days of excessive leveraging. What we expect to see is a rise in revolving debt that is concomitant with an increase in household income.

The third important point to make is that with incomes rising, Americans have the ability to BOTH increase spending and add to their personal savings. Thus, while personal consumption expenditures rose 0.4% last month, Americans were also able to lift the savings rate to 5.7% from 5.6%.

As for the holiday shopping season, we continue to stick with our earlier forecast that consumers will spend 4.5% to 5% more than last year. That's double the prediction made by the National Retail Federation.

Consumer Sentiment

Given the backdrop described above, it should come as no surprise that consumers are more upbeat on the economy. The University of Michigan/Reuters consumer sentiment index rose to 71.6 this month from 67.7 in October. That's the highest level of optimism we have seen since last June.

OK, there were some disappointing economic reports too, but...

Not surprisingly, we got dismal news on the home sales front, as both new and existing home sales fell in October. Sales of the former declined 8.1%, while the latter slipped 2.2%. Certainly one major reason for this drop is the moratorium on foreclosures. Homebuyers, whether they are investors or prospective residents, are not likely to go through with such large transactions if there are doubts about getting clear title to these properties. It may take a few more months before the legal embroilment on foreclosures gets sorted out. Another major drag on housing is how bank appraisers remain extra conservative in their valuations of residential real estate. Nothing can kill a home buying contract faster than if these valuations come in substantially below the negotiated price between buyer and seller. Banks are in no mood ease up on appraisals. After getting badly burned by the collapse in value of their real estate collateral, banks are in no mood to give mortgage-seekers much of a break.

One hopeful sign for housing was the surprisingly high number of new mortgage applications filed in the latest week. According to the Mortgage Bankers Association, mortgage applications in the week ending November 19th jumped by the most in two years. Applications filed specifically to purchase homes (as opposed to those seeking to refinance) shot up 14.4%, the largest one-month jump since November 2008! But we have to temper our enthusiasm here a bit. Applications for mortgages can be a good leading indicator for home buying, but given all the structural problems facing residential real estate (e.g., excessive inventories of unsold homes, tight credit conditions, and a soft --- if improving -- job market), we're placing less weight on this measure as a forecasting tool.

Orders for durable goods

Finally, on the manufacturing front, orders for durable goods fell 3.3% in October and this was, admittedly, a surprise to us. Why? Given the improvement in new orders the same month by the Institute for Supply Management, along with the jump in exports and the hefty increase in the Federal Reserve's own manufacturing output last month, we had expected durable goods orders to stay positive.

Does this mean we should expect to see the start of a declining trend in business capital spending? No. Anyone who follows orders for durable goods knows it is an extremely volatile series, with little month-to-month correlation for business investments. We view it as a temporary pause, perhaps triggered by uncertainties over the mid-term election, unresolved policies issues on the extension of Bush's tax cuts, and fresh concerns about Europe's debt problems.

All in all, this week's numbers show the economy continues to move in the right direction, especially in terms of employment and household spending. If consumer demand keeps growing, as we expect it will, business capital spending will shortly resume its climb as well.

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