U.S.News & WORLD REPORT

Signs of a Surprising Economic Boom

By RICK NEWMAN
February 4, 2013

Bad news has rarely seemed so good.

After several discouraging reports on the economy, forecasters are starting to believe 2013 could turn out better than expected. The recent bad news has gotten plenty of attention: The latest GDP report, for instance, shows the economy shrank at the end of 2012. And the unemployment rate ticked upward in January, to 7.9 percent. Those are gloomy numbers more consistent with a recession than a robust expansion.

But underlying economic trends are better than those headline numbers suggest. Many economists think the fourth-quarter GDP contraction, for example, was an anomaly related to the fiscal-cliff deadline at the end of 2012. One hint is that defense spending plummeted during the fourth quarter, after rising by more than usual the quarter before.

That suggests defense agencies accelerated spending last year, out of concern that their budgets would get cut as part of the fiscal-cliff deal. That didn't happen, with spending cuts that were supposed to go into effect January 1 delayed until March 1.

The January unemployment report was lackluster, but there were big upward revisions to earlier numbers, which happens sometimes as government statisticians gather more data and refine their methodologies. In November and December, employers added 443,000 jobs, according to the new estimates, rather than 301,000, as previously reported. That's 142,000 additional jobs in just two months.

There was also a sizeable drop in the number of long-term unemployed in the latest report, with that number falling to the lowest level since 2009. Meanwhile, for all of 2012, the total employment tally was 647,000 more jobs than prior numbers showed. (Note to conspiracy theorists: If the Obama administration were inflating the numbers, wouldn't they have done so before the November election?)

The upshot is that the economy may be considerably stronger than headline numbers have led us to believe. "This could be a breakout year for the economy," **Bernard Baumohl of the Economic Outlook Group** trumpeted in a recent note to clients.

There are several specific reasons economists are becoming increasingly optimistic. One is housing, which was a net drag on the economy until home prices bottomed out last year and starting drifting upward. Housing is now contributing to growth. Builders, for instance, have hired about 300,000 new construction workers during the last two years. A remodeling boom is boosting sales of appliances and other big-ticket items.

The upturn in housing, coupled with the strong performance of the stock market since 2009, has restored nearly all of the household wealth lost between 2007 and 2010. Before the recession, Americans' total net worth peaked at about $66 trillion. It bottomed out at about $49 trillion in 2009, but has now bounced back to $65 trillion or so and will probably exceed the earlier peak soon. That's a huge relief for millions who used to feel their hard-earned wealth was simply evaporating.

Other hopeful signs of an economic rebound: Income and spending have been rising more than expected, and Americans saved a higher than average portion of their income at the end of 2012. Business spending may be on the verge of picking up, too.

And traders hope the strong stock-market performance in January, when the S&P 500 stock index rose by 5 percent, augurs a yearlong rally. In years that start with a January gain, the stock market rises by an average of 11.2 percent, according to Sam Stovall of S&P Capital IQ—thus the adage, "As goes January, so goes the year."

There's still plenty that could go wrong, starting with ongoing budget battles in Washington that could drain confidence and torpedo the economy. Consumers already seem wary on account of the expiration of the payroll tax cut, which has trimmed the size of every paycheck in 2013. And the down-to-the-wire fiscal cliff negotiations late last year showed that Washington politicians are as deaf as ever to concerns in the real economy.

But Americans may also be growing more inured to political dysfunction. The stock market didn't tank in the run-up to the fiscal cliff, as some investors worried might happen. Consumers didn't close their wallets either, and businesses hired in modest numbers when many analysts expected them to put everything on hold.

If those trends continue in 2013, what happens in Washington will matter less and less, which could be the best economic development of the last five years.

###