

THE ECONOMIC OUTLOOK GROUP



475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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The Best Thanksgiving Economy In Three Years

The latest cascade of economic reports tells us this recovery is very much on track. Not only is the probability of a double dip recession receding by the day, but we're also starting to see signs the economy is on a stronger footing than anyone would have imagined a few months ago.

To be sure, we're not predicting an explosive post-recession bounce. Such a comeback is inherently impossible since banks are still largely unwilling to finance consumer and business activity. What is impressive, though, is how effectively the private sector and the government have worked together to revitalize an economy that was virtually comatose earlier this year.

The improvement in the economy's momentum is noticeable in some of the recent set of numbers:

1. **Claims for jobless benefits** finally crossed below the 500,000 threshold to 466,000 in the week ending November 21st. That's down 35,000 from the week before and the lowest level in more than a year! Take out the month-to-month volatility and the four-week moving average has first-time claims down to 496,500, that is 16,500 less than the week before. True, we're still a long way off from the 300,000 weekly claims that is typical of an economy operating on all cylinders. However, the downward trend is

critically important for its psychological impact. Remember, nine out of ten people in the labor force are currently working and the deceleration in layoffs helps reduce anxieties over job security and will thus encourage more spending.

2. We saw some of that already surface with the **Personal Income and Spending** report. Consumer expenditures rose 0.7% in October, the fifth increase in six months. (The only reason spending fell in September was because it followed the “cash for clunkers” program, which ended in August.) With the recession now history, layoffs diminishing, and the stock market rebounding, consumers will feel more at ease about unleashing some of the pent-up demand that has been built up over the last two years.

Three other noteworthy points about this report: Purchases of durable goods, normally pricey items that are usually bought on credit, rose a healthy 0.9% in October after falling 2.3% the month before (again, blame the expiration of cash for clunkers for that decline). Second, the growth in personal income rose to a \$12.14 trillion annual rate in October, second highest of the year. And when you adjust for taxes and other payroll fees, actual take home pay (disposable personal income), jumped to \$11.07 trillion, the highest this year, laying the groundwork for more spending in the months ahead.

3. Another closely watched indicator is **New Home Sales** and it, too, came in better than expected. Purchases jumped 6.2% last month to a 430,000 unit annual rate, the strongest performance since September 2008. That’s a 31% increase from January’s low. This report comes on the heels of the 10% increase in sales of existing homes.

The combination of rising sales of new homes and little new construction brought the inventory of unsold new homes down to a 6.7 months supply, the lowest since December of 2006. The actual number of new homes ready for sale fell to 239,000, the smallest in 38 years! With inventories this low, we expect to see new home construction ramp up in coming months, along with more construction hiring and the purchase of building material. One little known but meaningful statistic in this report is the purchase of lots by homebuyers (listed as “houses not started”), which has been on the rise lately. As the supply of new homes dwindle, prospective buyers start looking at lots. Lot sales are thus an excellent leading indicator of new construction.

4. Yes, there were some disappointing economic stats out today. **Orders for Durable Goods** turned out to be a wash when you look at its performance the last two months. New orders did fall 0.6% last month, but it followed an upward revised 2% increase in September. If you take out the volatile transportation component, orders declined 1.3%, but again this drop followed a 1.8% increase the month before. During the early stages of a recovery we look closely at the demand for primary metals, the precursor to future industrial output, and once again we see demand continue to improve. New orders for primary metals shot up 3.6% in October, and that came after increases of 2.6% in September and 1.3% in August.

5. The **University of Michigan’s Consumer Sentiment index** did slip a little this

month, falling from 70.6 in October to 67.4. It was the second drop in a row. We assume this decline was in reaction to the larger than expected jump in October's jobless rate, from 9.8% to 10.2%, the highest in 26 years. It would have been unusual for consumers to feel anything but uncomfortable by that double-digit jobless rate ---- even though it is a lagging indicator. In addition, people are uneasy about a host of other issues: the increasingly acerbic debate over health care, the exploding budget deficit, the difficulty in obtaining financing from banks, the deepening role of government in the private sector, the wars underway in Afghanistan, Iraq, and Pakistan. These are stressful times and we are unlikely to see a dramatic pick up in confidence given these concerns.

Still, we need to point out that there is no short-term correlation between the confidence of consumers and their propensity to spend. Americans may be uneasy, but that alone will not keep them away from stores now that the economy is recovering, incomes are rising, and the labor market showing signs of turning around.

Bottom line:

To say the U.S. economy is now in its best shape in three years may sound like hyperbole. But we choose to look at the fundamentals. The recovery has commenced and spread worldwide. The excesses in real estate and of private sector leverage are being cleaned up. Corporate profits are rising. The U.S. is much more competitive in the global marketplace. Inflation is nowhere to be seen. Banks have healthier --- if not yet ideal --- balance sheets. Americans are seeing a recovery in household net worth. Last, but certainly not least, the composition of growth in the U.S. is undergoing a tectonic shift, with investments and exports to play a more prominent role than consumption. It's a transformation that was long overdue and firmly sets the stage for a lasting recovery.