



V I E W P O I N T

THE ECONOMY

July / 2011
Vol. 78, No. 97

Lowering 2Q GDP Estimate

Supply chain disruptions, tightening in China and other emerging nations and the latest episode in the Eurozone debt crisis have all impacted the pace of global economic growth. In the U.S., storms, floods and tornadoes in the South and Central regions dampened spending and home sales.

In response to the developments, we have reduced our Q2 GDP estimate from over 3% to 2% (please see Chart 1 on Page 2 and the Economic Table on Page 3).

But sensitive market, financial and economic indicators do not point to a serious or persistent slowdown. Indeed, they suggest that the cumulative impact of the global and domestic difficulties will be less severe than in the period of subpar growth in the middle of last year.

We compared the current trends of key sensitive economic indicators with their trends a year ago. In every case they are stronger or holding up better at this time. For example, a year ago the Fed's Major Trading Partners (MTP) U.S. Dollar Index appreciated at an 11% rate in the first half of the year. This year it has depreciated at a 9% pace, helping the earnings of U.S. exporters and multinationals. The 10% drop in the dollar since June 2010 represents one of the best currency gains for U.S. stocks since 2003.

In addition, the money supply is accelerating. Growth of the money supply, a leading indicator of economic growth, has been rising since last summer. This is an important reason we think the current slowdown is temporary and that spending will pick up in the second half of this year.

Unemployment claims are lower. The four-week average of

initial unemployment claims is currently about 425,000—down from 440,000 in mid-May. One year ago, it was 467,000 and rising (on the way to 488,000 in early September). As in the year-ago period, claims are likely to stay high well after the period of sluggish growth ends. A decline of the four-week average below the March low of 388,000 would indicate that economic growth is picking up again.

Finally, banks are making business loans. Growing corporate credit needs are clearly visible in both Bank Commercial & Industrial (C&I) lending and in the commercial paper (CP) market. C&I loans and CP outstanding have been growing at 7% and 27% growth rates in the past six months. A year ago, loans were running off at a 13% rate and CP was falling at a 12% pace.

We look for GDP to rebound in 2H11 back to the 3% level.

Consumer Metrics Flatten a Bit

Retail sales and personal income continue to head higher, this according to the latest government data. But consumer confidence has slipped in the past month (please see Chart 2 on Page 2).

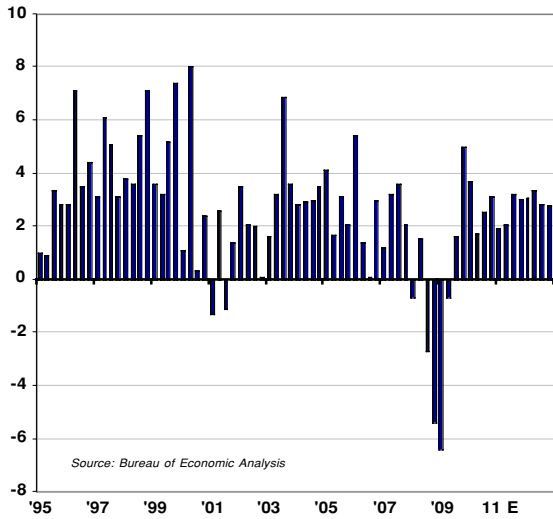
Many economists have recently lowered their forecasts for the consumer sector based on the spike in oil prices since the Mideast uprisings began in Egypt — but we expect this all-important segment of the economy to grow at a solid low-single-digit pace through 2011.

Auto sales, which were above a 13.3-million annual run

(continued on back page)

TABLE 1

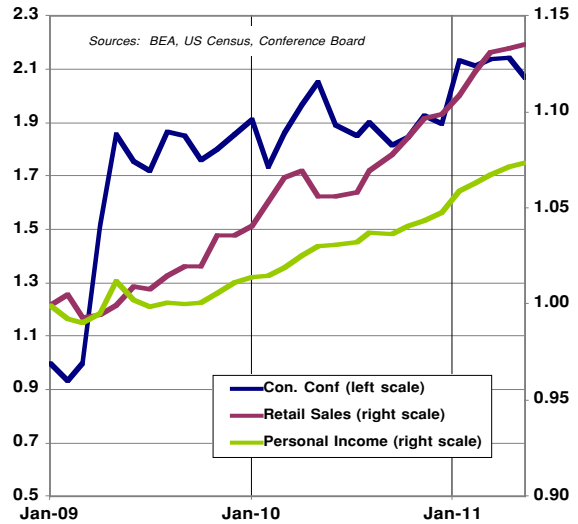
REAL GDP



We expect GDP growth to pick up in the second half of the year.

TABLE 2

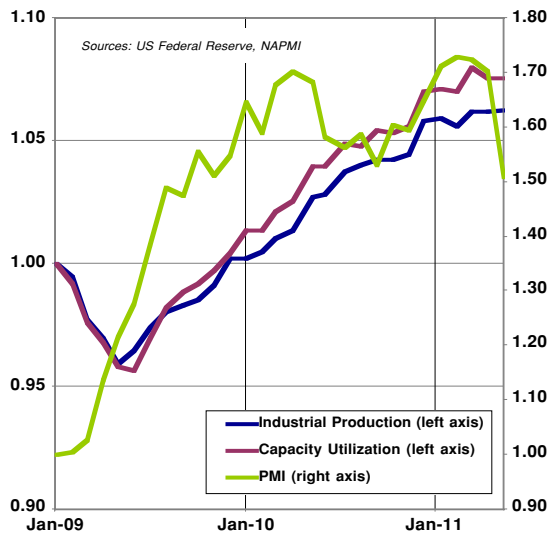
CONSUMER TRENDS (INDEX 1/09 = 1.0)



Consumer Confidence has fallen as oil prices have climbed.

TABLE 3

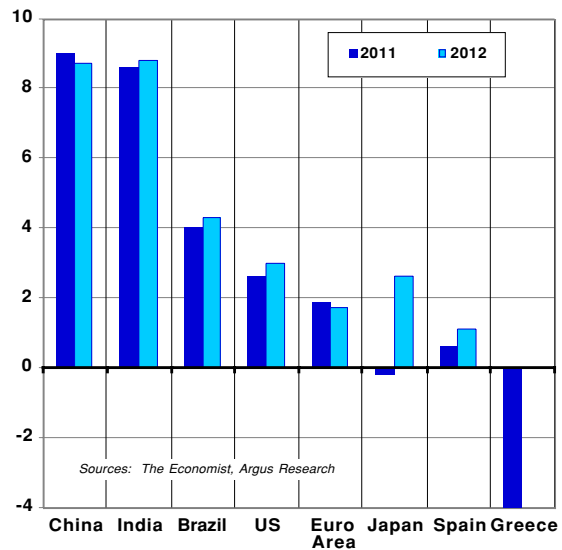
INDUSTRIAL SECTOR METRICS (INDEX 1/09 = 1.00)



Though industrial trends have weakened, they still point to economic expansion.

TABLE 4

GLOBAL GDP FORECAST (RATES OF Y/Y GROWTH)



China is the wild card to global economic growth. Once Chinese officials loosen monetary policy, we expect to see global growth accelerate.

GDP FORECAST

Revised as of June 28, 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	1.9	2.1	3.2	3.0	3.1	3.4	2.8	2.8
Annual:				0.3				2.8								3.0
Personal Consumption	0.6	-0.9	2.2	1.9	1.9	2.3	2.5	4.4	2.3	2.0	2.1	1.9	7.7	0.8	0.2	1.7
Goods	2.5	-3.1	7.2	2.9	5.7	3.3	4.3	10.1	4.3	1.3	3.6	2.4	9.3	1.8	0.0	1.2
Durables	3.9	-5.6	20.4	0.4	8.8	6.8	7.6	21.1	9.3	1.6	6.4	3.1	15.0	4.7	0.0	1.5
Non-Durables	1.9	-1.9	0.0	5.6	4.2	1.9	2.5	4.1	1.4	1.0	1.9	1.9	5.9	0.0	0.0	0.9
Services	-0.3	0.2	0.8	1.0	0.1	1.6	1.6	1.5	1.3	2.4	1.3	1.6	6.8	0.3	0.3	1.9
Gross Domestic Investment	-50.5	-23.7	-7.0	66.1	29.1	24.1	14.4	-15.6	11.5	-4.4	8.3	8.3	5.1	4.7	2.5	5.5
Fixed Investment	-39.0	-12.5	-14.4	20.2	3.3	35.5	2.0	6.9	2.1	1.3	6.0	8.5	6.2	4.8	4.7	5.5
Non-Residential	-39.2	-9.6	-8.5	6.7	7.8	18.2	10.8	7.7	3.1	2.2	7.1	9.9	5.8	5.4	5.3	5.2
Structures	-43.6	-17.3	-18.4	-18.1	-17.8	-0.5	-3.6	7.7	-14.8	0.9	13.5	13.1	9.9	0.0	0.0	0.0
Equip. & Software	-36.4	-4.9	1.5	19.0	20.4	24.8	15.4	7.7	8.7	2.5	5.4	9.0	4.6	7.0	6.8	6.7
Residential	-38.2	-23.2	18.9	3.7	-12.3	25.6	-27.3	3.3	-1.9	-2.8	1.2	2.5	7.9	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	55.7	30.0	40.0	40.0	40.0	40.0	30.0	30.0
Net Exports																
Exports	-29.9	-4.1	8.4	-2.5	11.4	9.2	6.7	7.6	0.7	1.1	1.1	2.3	16.5	6.8	6.8	4.4
Goods	-36.9	-6.3	17.5	23.1	14.0	11.5	5.9	10.2	1.1	0.0	0.0	0.0	2.7	6.6	6.6	3.2
Services	-13.6	0.2	24.6	34.1	5.8	3.9	8.9	1.7	-0.2	4.0	4.0	8.0	55.8	7.2	7.2	7.1
Imports	-36.4	-14.7	5.6	2.7	11.2	33.5	16.8	5.0	3.8	-0.9	-0.9	0.0	5.8	-7.2	-7.2	0.0
Goods	-41.0	-16.5	21.2	16.1	12.0	40.5	17.4	5.6	4.2	0.0	0.0	0.0	4.2	-8.6	-8.6	0.0
Services	-11.5	-7.5	25.1	20.6	7.8	4.4	14.3	1.8	2.3	-5.4	-5.4	0.0	14.1	0.0	0.0	0.0
Gov't Purch of Goods & Svcs.																
Federal	-2.6	6.7	3.2	-1.3	-1.6	4.1	4.0	-1.6	-5.8	1.4	0.1	1.6	6.3	0.8	1.5	1.9
National Defense	-4.3	11.4	7.9	0.1	1.8	9.1	8.8	-0.3	-8.0	1.8	0.3	3.9	4.0	2.0	3.6	4.6
Non-Defense	-5.1	14.0	8.4	-3.6	0.4	7.4	8.5	-2.2	-11.8	2.8	0.0	0.0	11.7	1.1	1.7	1.1
State & Local	-2.4	6.1	7.0	8.3	5.0	12.8	9.5	3.7	0.0	0.1	0.8	11.7	-9.7	3.8	7.7	11.7
	-1.6	3.9	-0.6	-2.2	-3.8	0.6	0.7	-2.6	-4.1	1.0	0.0	0.0	8.0	0.0	0.0	0.0
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

(continued from page 1)

rate in April, dropped to an 11.9 million rate in May (in large part based on supply chain disruptions emanating from Japan). The two drags on the consumer are unemployment and housing prices. These factors are keeping Consumer Confidence below 60.

That said, we think contrarian investors have a better opportunity when the consensus is not clear. The last peak in Consumer Confidence — above 100 — occurred at the last stock market peak in 2007.

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 (please see Chart 3 on Page 2).

For example, capacity utilization has hovered below 77% for since March, 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 three months at 93.0 — still much higher than the reading of 83.5 in June 2009. And in the latest month, the most forward-looking metric, the survey of Purchasing Managers, plunged from 60.4 to 53.5 — though again, this reading is above the expansion/contraction line of 50, and substantially higher than the reading of 35 during the middle of the Great Recession.

We are not surprised to see a temporary pause, much of which has been driven by supply disruptions in Japan. 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. Further, the low level of the sales/inventory ratio suggests that companies will be building stockpiles over the next few quarters.

Trading Partners Growing

The U.S. Federal Reserve has trimmed its forecast for domestic growth, but forecast growth rates for most of the nation's trading partners are steady (please see Chart 4 on Page 2).

Estimated growth rates for the BRIC nations (Brazil, Russia, India and China) are on average 6.5%, though the yield curve is inverted in China and output for 2012 is expected to advance at "only" an 8.7% rate.

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 until the Greek crisis is resolved.

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

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