

# Weekly Economic Commentary

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### Highlights

- Episodes of “economic momentum” have been rare in the past 20 years.
- Recent evidence points to modest momentum in the U.S. economy as 2011 turned into 2012.
- Another round of economic speed bumps could temper hard-won momentum.

### Economic Calendar

<b>Monday, January 9</b>	Retail Sales
Construction Spending	<i>Dec</i>
<i>Nov</i>	Business Inventories
<b>Tuesday, January 10</b>	<i>Nov</i>
Wholesale Inventories	Treasury Statement
<i>Nov</i>	<i>Dec</i>
NFIB Small Business	<b>Friday, January 13</b>
Optimism Index	Trade Balance
<i>Dec</i>	<i>Nov</i>
JOLTS Data	Import Price Index
<i>Nov</i>	<i>Dec</i>
<b>Wednesday, January 11</b>	U of M Consumer
Beige Book	Sentiment
<b>Thursday, January 12</b>	<i>Jan</i>
Initial Claims	
<i>wk 1/7</i>	

## Does Economic Momentum Exist?

In June 2011, Federal Reserve (Fed) Chairman Ben Bernanke noted that the economic recovery had been “uneven across sectors and frustratingly slow.” In November 2011, Bernanke said that there “have been some elements of bad luck” impacting the economy. Even before November, however, the recovery had been picking up some steam.

Has the economy’s luck turned, and is some forward momentum happening finally? This week’s rather modest set of data, compared to the deluge of data in the first week of 2012, is unlikely to change the market’s view that the U.S. economy gained some momentum as 2011 ended and 2012 began.

The slate of economic data this week—which includes early January readings on initial claims for unemployment insurance and weekly retail sales, December readings on retail sales and consumer sentiment, and November readings on job openings, business inventories and merchandise trade—will likely continue to show that the economy gathered momentum as 2011 drew to a close. The Fed’s Beige Book, a qualitative assessment of banking and business conditions in each of the Fed’s 12 regional districts, is also likely to garner significant market attention ahead of the late January Federal Open Market Committee (FOMC) meeting. Overseas, Chinese economic reports for December are due this week and are likely to show that China is headed for a soft landing, not a hard landing, and, more importantly, that Chinese inflation continued to moderate in December, which paves the way for more monetary policy easing in China in the coming weeks.

### Economic Momentum Is Rare

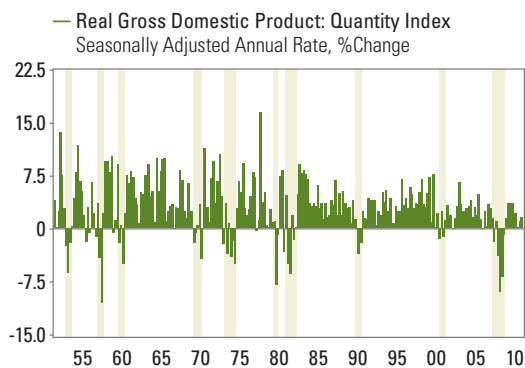
The U.S. economy rarely proceeds, either forward or backward, in a straight line, accelerating or decelerating evenly as a car would when its driver is applying steady pressure to the gas pedal or the brakes. Normally, economic growth in the United States from quarter to quarter is a series of uneven fits and starts, acting more like a car with a manual transmission being operated by a teenager just learning how to drive.

As noted in the nearby chart, over the last 60 years, the quarter-to-quarter change in gross domestic product (GDP), the most comprehensive measure of the health of the economy, has rarely moved steadily up (or down) for more than a few quarters at most [Chart 1]. The last time the economy steadily accelerated for three consecutive quarters was in mid-2004 into



The last time the economy steadily accelerated over four consecutive quarters was in the mid-1950s!

## 1 Economic Momentum Is Rare

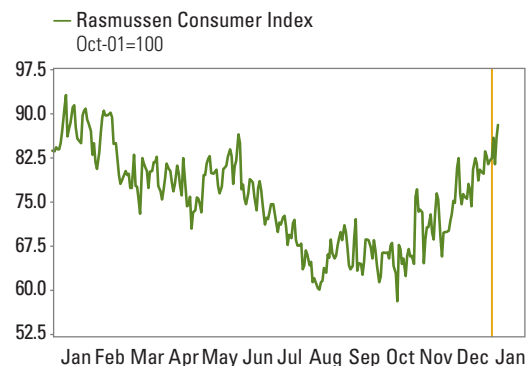


Source: Bureau of Economic Analysis, Haver Analytics 01/09/12

(Shaded Areas Indicate Recession)

Real Gross Domestic Product Quantity Index is a number that measures the change of output (quantity) from a base year. The value of the quantity index is 100 for the base year.

## 2 Surging Consumer Sentiment is One Sign That the Economy Has Some Momentum as 2011 Turns into 2012



Source: Rasmussen Reports, Inc., Haver Analytics 01/09/12

The Rasmussen Consumer Index and Investor Indexes, measures the economic confidence of consumers on a daily basis. The Rasmussen Consumer Index and Investor Indexes are derived from nightly telephone surveys of 500 adults and reported on a three-day rolling average basis. The baseline for the Index was established at 100.0 in October 2001.

early 2005. The last time the economy steadily accelerated over four consecutive quarters was in the mid-1950s!

During the first nine quarters of the current economic expansion (which began in mid-2009), the economy has posted an average annualized growth rate of just 2.4%. This pace of growth trails the average growth rate experienced over similar time periods after the mild 1990–91 and 2001 recessions (2.8%), and is well below the average growth rate (5.7%) seen in the nine quarters after the severe 1973–75 and 1981–82 recessions.

However, over the first three quarters of 2011, the economy actually accelerated in a straight line, with growth in the first quarter increasing at a 0.4% annualized rate, 1.3% in the second quarter, and 1.8% in the third quarter. Our view is that the straight-line acceleration will continue into the recently completed fourth quarter of 2011, with real GDP rising at a 3.0 to 3.5% pace versus the third quarter. The third quarter GDP data is due out in late January, although financial markets have probably already discounted the acceleration in economic growth in the fourth quarter. Market participants are now more concerned with growth prospects in the current first quarter of 2012, and, to a larger extent, growth prospects for all of 2012.

The longer-term growth rate (or speed limit) for the U.S. economy is regulated by the growth in the labor force plus the output per worker (productivity). The Great Recession and its aftermath had noticeable impacts on both the growth in the labor force and productivity. However, the Fed (and other market participants) estimate the U.S. economy's longer-term speed limit as being around 2.5 to 3.0%. Often, the economy is subject to temporary factors (natural disasters, unusual weather, supply chain disruptions, worker strikes, geopolitical events, etc.) that depress growth for a quarter or two, and the economy grows at a pace below its long-term potential. Once those factors fade, the economy oftentimes plays "catch up", and growth can accelerate for a quarter or two, and grows above its long-term potential growth rate.

Recently, most of the fits and starts impacting the economy have depressed, rather than boosted, economic growth. From the fourth quarter of 2009 through the second quarter of 2010, the economy grew at 3.8%, 3.9%, and 3.8% as growth accelerated from the end of the Great Recession in the second quarter of 2009. However, the first flare-up of the European fiscal crisis in the spring and summer of 2010 (Greece, Portugal and Ireland) acted to depress growth, and later in the year and into 2011, rising consumer energy prices (largely the result of political turmoil in the Middle East) also pressured growth. By mid-2011, the European fiscal crisis broadened out, the dysfunction in Washington surrounding the U.S. fiscal situation negatively impacted both business and consumer sentiment, and the earthquake in Japan in March 2011, along with the long lasting disruptions to the global supply chain, slowed growth to nearly stall speed. An unusually snowy early 2011, together with record flooding and tornadoes in the U.S., also hampered growth in early 2011 [Chart 2].



## Momentum Turned in Late 2011

As 2011 turned into 2012, however, many, but by no means all, of these temporary factors that depressed growth between mid-2010 and mid-2011 were fading and beginning to reverse course, which appeared to provide the economy with some momentum:

- The global supply chain disruptions due to the earthquake in Japan had largely run their course, although massive flooding in Thailand in mid-to-late 2011 has already begun adversely impacting output of some key components in the technology area.
- Consumer energy prices moved sharply lower over the second half of 2011, and declines in food prices have also helped to cool consumer inflation.
- The fiscal and legislative concerns surrounding the debt ceiling, our nation's credit rating, and the extension of payroll tax cuts and unemployment insurance benefits appear to have waned for now. In general, the market and economy-driving political battles that hampered growth in 2011 are unlikely to be repeated in 2012, although they simmer just below the surface.
- While the uncertainty surrounding the European fiscal situation remains a concern for consumers and businesses, our view is that recent policy actions by European politicians and the European Central Bank (ECB) have taken the worst case scenario off the table for now.

Looking ahead, warmer-than-usual weather, monetary policy easing in China, strong auto production schedules for the first quarter, the recent drop in initial claims for unemployment insurance, the surge in consumer sentiment, and the solid December jobs report (released on Friday, January 6) all suggest that "economic momentum" will persist into the first quarter of 2012. However, with several sectors of the economy still struggling (housing, state and local government, construction of office parks, malls and factories), another round of economic speed bumps could very easily slow the economy's hard won momentum as 2012 progresses.

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### IMPORTANT DISCLOSURES

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