

**ECONOMICS:** US PERSPECTIVES—JANUARY 29, 2010

# Recovery Begins with a New Mix of Drivers Shaping US Economic Growth

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The US economic recovery is in full swing, with fourth-quarter growth helped by a large shift in the inventory component. We believe that new GDP data highlight a new mix of growth, as surging exports and a rebound in business investment offset smaller contributions from the consumer and housing sectors.

The US economic recovery is becoming a reality, after months of signals pointing toward the imminent end of the longest recession in postwar history. According to the preliminary estimates released Friday by the Bureau of Economic Analysis, fourth-quarter real GDP rose at an annualized rate of 5.7% (**Display 1**), posting its second consecutive quarterly gain and the fastest growth since the third quarter of 2003.

These figures are somewhat stronger than we had expected and provide further support to the view that the US economic recession ended last summer. Based on the new data, we expect the National Bureau of Economic Research, the official arbiter of economic cycles, to formally determine that the economic recession ended last June, 18 months after it began in December 2007.

Inventory investment was the biggest contributor to fourth-quarter growth, accounting for 3.4 percentage points of the increase in overall real GDP. Such a substantial boost from inventories creates

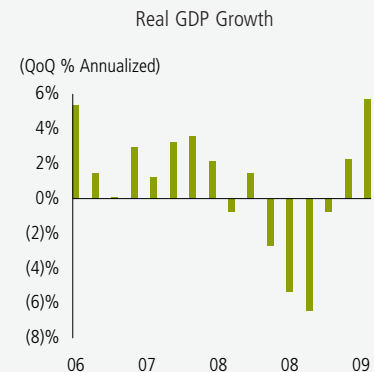
an impression that the relatively strong economic rebound in the fourth quarter was due to a one-off inventory adjustment and is unlikely to be repeated. However, when placed in historical context and understood within the wider GDP framework, we think inventory investment will continue to be an important factor in the recovery during the coming quarters.

### Understanding Inventory in Context

GDP is a measure of output, which is constructed by summing all of the spending on final goods and services—or purchases made by consumers, businesses, government and foreign customers (less imports)—and then adding the change in inventories. In recent quarters, business inventories were contracting, sometimes at substantial rates, meaning companies were producing less than they sold to customers at home and overseas.

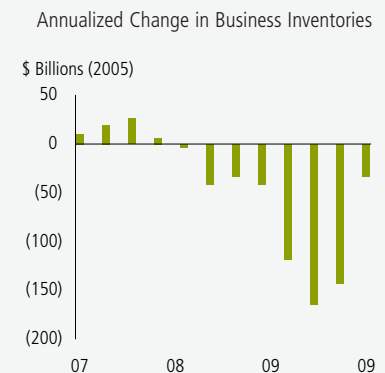
During the fourth quarter, even though inventory investment added substantially to GDP growth, companies still produced less than they purchased, as business inventories contracted again. But as the

Display 1  
GDP Rebound Shows Recession Over



Source: Bureau of Economic Analysis and Haver Analytics

Display 2  
Big Lift From Inventories



Source: Bureau of Economic Analysis and Haver Analytics

rate of inventory liquidation slowed dramatically from \$139.2 billion in the third quarter to \$33.5 billion in the fourth quarter (**Display 2**), it subtracted less from

GDP. This sharp reduction therefore contributed to fourth-quarter GDP growth. It implies, as we argued in last week's economic report, that GDP will continue to benefit strongly when companies begin to build up inventories in the months ahead.

The lift from inventory investment over the past two quarters may appear deceptively large on a quarterly or combined basis. But the two-quarter contribution is actually in line with past economic recoveries. Indeed, the average contribution from inventory investment during the first six months of economic recoveries was two percentage points—almost identical to the 2.1 percentage point combined gain registered in the third and fourth quarters of 2009.

We therefore believe that the big lift from inventories over the past two quarters should not preclude a substantial contribution in the quarters ahead, as the recent performance is in line with previous cycles and companies have not even started to build stock positions, which is the next step in the inventory cycle and an important driver of growth in the early stages of the economic recovery.

### New Mix of Growth Appears

Aside from the big shift in the inventory cycle, the GDP data are broadly consistent

with our view that the US economy is likely to be driven by a “new mix” of growth in the short term. In particular, consumer spending and housing is making a smaller contribution to the recovery, while exports have rapidly become a powerful growth engine (**Display 3**).

In previous economic recoveries, at this stage of the business cycle, real GDP growth typically has been driven by the traditional domestic demand engines such as consumer spending and housing. We wouldn't normally expect a significant contribution from the global economy via exports just yet, since in the past, global business cycles were always led by rising demand from the US. This pattern has been reversed: in 2009, emerging markets recovered before industrial economies and are growing more than twice as fast as the US economy (**Display 4**).

The changing dynamics in the global recovery explain why exports are driving US GDP growth, instead of the traditional domestic demand engines such as consumption and housing. During the past two quarters, exports jumped by an impressive 18% annualized rate, by far the strongest GDP component. Export growth has lifted GDP growth by 1.8 percentage points, well above its historical contribu-

tion of a mere 0.2 points. Strong exports almost fully offset the weaker than average contributions to GDP from the consumer and housing sectors.

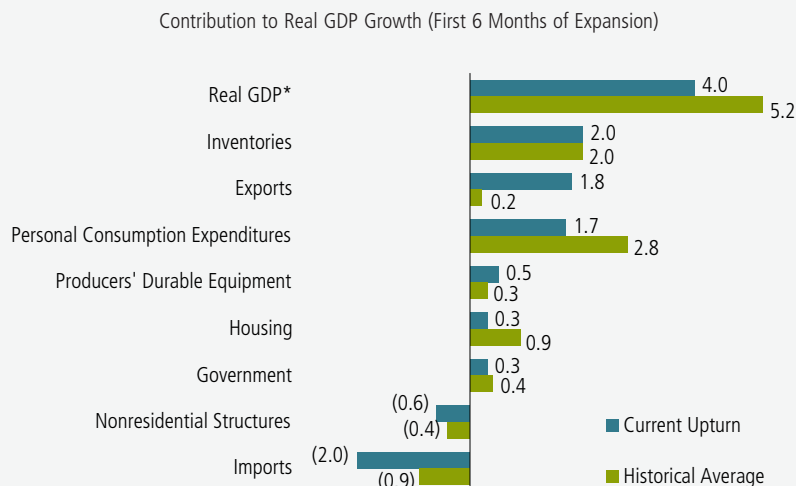
### Consumer Spending Remains Weak

In contrast, real consumer spending rose at an annualized pace of just 2.4% during the current upturn, while housing advanced 12.3%, albeit from a very low base. The two consumer-oriented sectors added two percentage points to GDP growth, a little more than half of the average 3.7 point contributions of the past six upturns. We're not surprised by the relatively muted role of consumer spending and housing, as the household sector is still in the process of de-leveraging and the housing sector is still working off excesses of past years.

We expect the GDP trends of the past six months to remain in place throughout the year. In fact, a leaner and more competitive US manufacturing sector is poised for robust exports that may advance twice as fast as overall GDP growth. Directly and indirectly, through investment spending and inventory building, the strong export sector will account for a large part of the 4% growth in real GDP that we are forecasting for the US economy in 2010.

Display 3

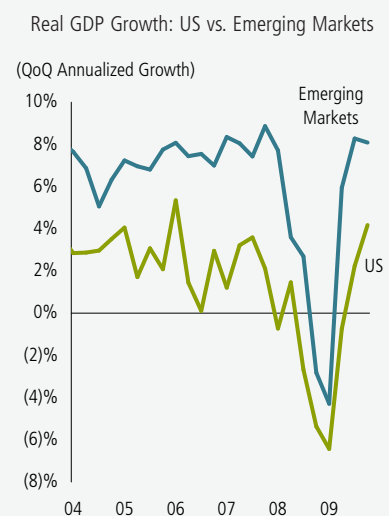
#### GDP Growth Leadership Coming From Exports



\* Annualized Change for 6 months  
Source: Bureau of Economic Analysis and AllianceBernstein

Display 4

#### Emerging Markets Fuel US Exports



Source: Haver Analytics and National Accounts

Levels (2000 Dollars)	Quarterly					Annual			
	4Q09	1Q10	2Q10	3Q10	4Q10	2007	2008	2009	2010
Real GDP	13155.0	13284.4	13402.4	13530.4	13675.4	13254.1	13312.2	12988.7	13473.2
Consumption	9298.5	9360.2	9416.2	9467.2	9527.2	9314.0	9290.9	9237.3	9442.7
Durables	1120.3	1128.0	1135.0	1145.0	1160.0	1200.0	1146.3	1100.5	1142.0
Nondurables	2054.6	2065.0	2084.0	2095.0	2110.0	2074.8	2057.3	2037.3	2088.5
Services	6116.4	6160.0	6190.0	6220.0	6250.0	6040.8	6083.1	6090.5	6205.0
Investment									
Nonresidential Structures	364.6	360.0	360.0	363.0	368.0	441.5	486.8	391.1	362.8
Nonresidential Equip & Software	907.7	930.0	955.0	980.0	1000.0	1097.0	1068.6	887.9	966.3
Res Structures	364.6	370.0	378.0	390.0	408.0	585.0	451.1	359.1	386.5
Change in Inventories	-33.5	5.0	15.0	35.0	45.0	19.5	-25.9	-111.7	25.0
Net Exports	-341.1	-330.0	-320.0	-305.0	-280.0	-647.7	-494.3	-353.9	-308.8
Exports	1541.6	1580.0	1610.0	1640.0	1680.0	1546.2	1629.3	1468.6	1627.5
Imports	1882.7	1910.0	1930.0	1945.0	1960.0	2193.8	2123.5	1822.4	1936.3
Government	2584.4	2579.4	2588.4	2590.4	2597.4	2443.1	2518.1	2566.4	2588.9

Percent Changes	Quarterly % SAAR					% 4Q/4Q				Annual			
	4Q09	1Q10	2Q10	3Q10	4Q10	2007	2008	2009	2010	2007	2008	2009	2010
Real GDP	5.7%	4.0%	3.6%	3.9%	4.4%	2.5%	-1.9%	0.1%	4.0%	2.1%	0.4%	-2.4%	3.7%
Consumption	2.0%	2.7%	2.4%	2.2%	2.6%	2.0%	-1.8%	1.1%	2.5%	2.6%	-0.2%	-0.6%	2.2%
Durables	-0.9%	2.8%	2.5%	3.6%	5.3%	4.6%	-11.8%	4.0%	3.5%	4.3%	-4.5%	-4.0%	3.8%
Nondurables	4.3%	2.0%	3.7%	2.1%	2.9%	1.5%	-2.9%	1.4%	2.7%	2.5%	-0.8%	-1.0%	2.5%
Services	1.7%	2.9%	2.0%	2.0%	1.9%	1.7%	0.3%	0.6%	2.2%	2.4%	0.7%	0.1%	1.9%
Investment													
Nonresidential Structures	-15.4%	-5.0%	0.0%	3.4%	5.6%	18.9%	3.2%	-24.7%	0.9%	14.9%	10.3%	-19.7%	-7.2%
Nonresidential Equip & Software	13.3%	10.2%	11.2%	10.9%	8.4%	3.2%	-10.7%	-8.7%	10.2%	2.6%	-2.6%	-16.9%	8.8%
Res Structures	5.7%	6.1%	8.9%	13.3%	19.8%	-20.5%	-21.0%	-12.1%	11.9%	-18.5%	-22.9%	-20.4%	7.6%
Net Exports													
Exports	18.1%	10.3%	7.8%	7.7%	10.1%	10.2%	-3.4%	-1.7%	9.0%	8.7%	5.4%	-9.9%	10.8%
Imports	10.5%	5.9%	4.3%	3.1%	3.1%	0.9%	-6.8%	-7.7%	4.1%	2.0%	-3.2%	-14.2%	6.2%
Government	-0.2%	-0.8%	1.4%	0.3%	1.1%	2.5%	3.1%	1.6%	0.5%	1.7%	3.1%	1.9%	0.9%
Domestic Demand	5.1%	3.7%	3.2%	3.3%	3.5%	1.4%	-2.5%	-0.8%	3.4%	1.4%	-0.7%	-3.4%	3.3%

Key Macro Indicators	Quarterly					Annual			
	4Q09	1Q10	2Q10	3Q10	4Q10	2007	2008	2009	2010
Nominal GDP (Levels)	14463.4	14728.8	14953.0	15174.0	15433.3	14077.7	14441.4	14258.7	15072.3
%QoQ SAAR	6.4%	7.5%	6.2%	6.0%	7.0%				
%YoY	0.8%	3.9%	5.7%	6.5%	6.7%	5.07%	2.58%	-1.27%	5.71%
Industrial Production (Index)	99.7	101.0	102.5	104.0	106.0	111.3	108.8	98.3	103.4
%QoQ SAAR	7.0%	5.3%	6.1%	6.0%	7.9%				
%YoY	-4.6%	2.0%	6.3%	6.1%	6.3%	1.5%	-2.2%	-9.7%	5.2%
Housing Starts (Millions)	0.55	0.65	0.71	0.77	0.85	1.34	0.90	0.55	0.75
Industry Auto Sales (Millions)	10.8	11.2	11.5	12.0	12.0	16.1	13.2	10.3	11.7
Personal Savings Rate	4.0%	4.0%	4.0%	4.5%	5.0%	1.7%	2.7%	4.4%	4.4%
Unemployment Rate	10.0%	9.8%	9.5%	9.0%	8.8%	4.6%	5.8%	9.3%	9.3%
Operating Profits (%YoY)	31.9%	28.9%	26.4%	15.9%	8.0%	-4.1%	-11.8%	-3.5%	19.0%
After-Tax Profits (%YoY)	29.1%	31.0%	31.4%	18.5%	7.1%	-4.0%	-2.0%	-5.6%	21.0%

Inflation (%YoY)									
GDP Deflator	0.7%	3.4%	2.5%	2.1%	2.5%	2.9%	2.1%	1.2%	1.9%
Consumer Price Index	3.4%	1.7%	2.2%	2.2%	2.0%	2.9%	3.8%	-0.3%	2.4%

Key Interest Rates (End of Period)									
Federal Funds Rate	0.25%	0.25%	0.50%	1.25%	2.00%	4.25%	0.25%	0.25%	2.00%
Three-Mo T-Bill (BEY)	0.06%	0.25%	0.50%	1.25%	1.95%	3.25%	0.11%	0.06%	1.95%
Two-Yr Note	1.14%	1.10%	1.50%	2.25%	2.75%	3.05%	0.76%	1.14%	2.75%
10-Yr Note	3.85%	3.90%	4.25%	4.50%	4.75%	4.05%	2.25%	3.85%	4.75%
30-Yr Bond	4.63%	4.75%	5.20%	5.30%	5.50%	4.55%	2.69%	4.63%	5.50%

Source: AllianceBernstein

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