

**ECONOMICS:** US PERSPECTIVES—DECEMBER 16, 2011

# US Growth Expected to Rebound in 2012 After Uneven and Weak Year

■ **Joseph G. Carson**  
 US Economist and Director—Global Economic Research

A series of shocks along with ongoing structural adjustments slowed the US economic recovery in 2011. Although some key risks remain, we think that US economic fundamentals have improved enough to generate 3% growth in 2012.

It's been a volatile year for the US economy. After a series of external and internal shocks, as well as domestic political infighting over fiscal policy which led to a US credit downgrade, growth fell well short of our expectations from the beginning of 2011. But business conditions picked up late in the year, and we believe that the US economy is heading into 2012 with good momentum and potential for somewhat stronger growth, despite several unresolved risks.

In the first half, gross domestic product (GDP) growth was estimated at less than 1% annualized, despite relatively strong job creation early on and rapid gains in the manufacturing sector. Yet, overall business activity was held back by an unprecedented surge in commodity prices (**Display 1**), driven by unrest in the Middle East, and activity was slowed further by the earthquake in Japan that disrupted the global supply chain. In addition, lingering negative adjustments from consumer deleveraging, a weak housing market and cutbacks in state and local governments also restrained activity.

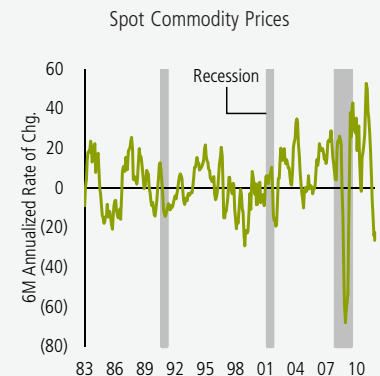
### Signs of Improvement

Economic growth improved in the second half to a pace of about 2.5%, increasing to an estimated 3% to 3.5% at the end of the year. The accelerated pace of growth in the second half reflects a rebound in the motor vehicle sector, following the disruptions to the global supply chain, as well as a pickup in consumer spending as gasoline prices retreated. Improved job growth and private construction also contributed to the gains, as did the recovery's biggest drivers—exports and capital spending.

We believe the US economy is heading into 2012 with good momentum, record low inventories, and improved consumer finances. In the corporate sector, profitability is high and cash flows are strong, while in the state and local government sector, we expect less of a drag owing to improved revenue growth.

Critics might argue that the economy had equally solid momentum going into 2011, but failed to sustain it. That's a fair point; however, the headwinds that hit economic

Display 1  
Commodity Price Spike Hurts 1H Growth



As of December 2011  
Source: Commodity Research Bureau and Haver Analytics

growth in 2011—commodity prices, Japan's earthquake and fiscal paralysis, and depth and breadth of the European sovereign-debt crisis—were unexpected. This made it hard for consumers, businesses and investors to prepare and adjust to the volatile economic environment in 2011.

Of course, there is still a major headwind from the European debt crisis in 2012. But we believe that monetary policy changes now in place should help limit the damage and potential spillover effects. It's also entirely possible that monetary easing in many key emerging-market economies such as China and Brazil could help offset the drag from the European slowdown,

especially since US exports to emerging markets are five times larger than exports to Europe. On balance, we expect the US economy to grow by 3% during 2012 as the domestic engines of consumer spending and private construction recover, and add to the ongoing gains in capital spending and exports.

### Income and Spending

Consumer spending was one of the weak spots in the early stages of the recovery. In 2012, we expect real consumer spending to rise by 2.25% to 2.5%, which is still relatively low from a historical perspective. However, if realized, it would mark the fastest gain since 2007. Improvement in labor markets and consumer finances, as well as an uptick in confidence, should lead to faster spending gains.

Incoming reports on labor market activity paint a picture of somewhat stronger job creation going forward. Jobless claims are lower than they've been all year, while hiring intentions are on the rise, according to the recent survey of small businesses and the latest report from the Manpower organization. The November survey of small businesses showed that hiring intentions had moved up to the highest levels since early 2008, while the Manpower hiring index rose to 2008 levels. While both readings are still low from a historic perspective, they indicate that the pace of hiring in the private sector, which has averaged 156,000 per month in 2011, should reach between 175,000 and 200,000 in 2012.

The improvement in labor markets is also evident in the civilian unemployment rate, which dropped 1.2 percentage points to 8.6% in November, and has helped lift consumer confidence recently. Both The Conference Board's measure of consumer confidence and the University of Michigan consumer sentiment index have rebounded in recent months. Signs of a revival in labor markets, income and confidence have quickly helped fuel the pace of real consumer spending, with overall gains

approaching 3% annualized in the fourth quarter, the best performance of the year.

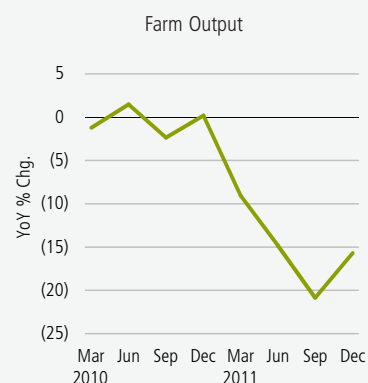
Often, the composition of the consumer spending basket provides information about underlying income growth, as well as how people assess their financial situation and overall confidence. The recent gain in durable goods spending, led by motor vehicles among others, suggests that consumers are becoming more willing to spend and use credit. Indeed, retail purchases of cars and light duty trucks hit their highest level of the cycle in November, and we forecast light duty vehicle sales of 13.5 million to 13.75 million units in 2012, up from an estimated 12.75 million in 2011.

### Capital Spending and Profits

According to our estimates, real capital spending will grow 10% in 2011, close to our initial expectations. Businesses stepped up their purchases of transportation equipment (+20%) and industrial equipment (+12%). Increased spending on technology equipment was less robust, rising about 7% over the year. The stepped-up pace resulted in a small gain in the net capital stock as investment outpaced depreciation for the second consecutive year. Given the robust gains in operating profits and net cash flow (+15%), we expect more solid gains in capital spending of 7.2% for 2012. Overall operating profits are estimated to be up between 6% and 7%.

Spending on short-lived equipment will probably slow down early next year, given that Congress has taken so long to vote on extending the 100% bonus depreciation in the tax code into 2012. In early 2011, we saw a similar reaction as businesses had assumed that special investment initiatives for 2010 would expire at year-end, and as a result pulled forward some of their capital spending expenditures into the fourth quarter. They then discovered at the end of year that the tax incentives for 2011 would be even more attractive. In the end, the change in tax law tends to influence the timing of purchases and has little impact on the overall level.

Display 2  
Sharp Drop in 2011 Farm Output



As of December 2011  
Source: Bureau of Economic Analysis and Haver Analytics

### Private Construction Rebounds

Private construction is on track to post a small gain this year for the first time since 2005, after one of the sharpest and longest contractions in postwar history. Based on data available for the first three quarters of 2011, US private construction spending is likely to increase by nearly \$10 billion—a minuscule amount worth less than 0.1% of GDP.

But we believe that the small gain marks a significant turn for the US economy. Housing starts for 2012 are estimated to be in the 650,000 to 675,000 range, which should generate a gain of at least 6.5% to 7% in residential construction.

### Many Export Sectors Thrive

In 2011, real exports grew an estimated 7%, a bit less than we expected at the start of the year. The smaller-than-expected rise in real merchandise exports was centered in agricultural exports—off an estimated 12% for the year. The drop in farm-related exports reflects a sharp 15% estimated decline in farm output during the year (**Display 2**). The unexpected drop in farm output subtracted 0.5 percentage point from GDP growth in 2011, which could easily be reversed in 2012.

Other exports categories actually met or exceeded our expectations, led by a 15% gain in motor vehicles, an 11% rise in capital goods and a 6% increase in industrial materials. In 2012, we estimate real exports should rise 6.4%, led by a sizeable rebound in commercial aircraft as Boeing steps up production to meet ongoing new order commitments.

### Government Spending Contracts

In 2011, real government spending is on track to contract by nearly 2%. Declines in state and local government spending are running at 2.5%, in line with our initial estimates. However, real federal spending is running at -2% on the year, versus our expectation of a small gain for the year. Most of the fall in federal spending is centered in defense, which is running \$20 to \$25 billion below what was appropriated for the year. We can't explain the shortfall, but we are not banking on a catch-up in 2012. Overall government spending is expected to rise less than 1% in 2012.

### Inflation Set to Moderate

In 2011, overall consumer prices are estimated to have increased 3.5%, almost 1.5 percentage points above our forecast

at the start of the year. The surge in commodity prices—oil and non-oil—acted as a huge drag on the economy, and drained purchasing power from consumers and businesses. In recent months, commodity prices have retreated, leading to a drop in retail gasoline and apparel prices, which should help the US consumer substantially. Many businesses, especially finished product manufacturers, are also likely to benefit as their input costs might decline in 2012.

In 2012, we estimate that consumer prices will increase between 2.0% to 2.5%, as lower commodity prices slow the price increases in various goods categories, including food.

### Fiscal Policy and Risks

We don't anticipate any incremental fiscal stimulus in 2012. Even though Congress seems poised to extend the payroll tax cut and the 100% bonus depreciation, an agreement has yet to be reached between the House and Senate. In addition, even if they forge a compromise by year-end, there are likely to be spending or tax changes to offset the stimulus from the payroll tax cut as well as more attractive depreciation allowances.

It's clear that the big tail risk for the US economy is coming from the European debt crisis. We think that new lending facilities put in place by the European Central Bank (ECB) reduce the risk of near-term banking collapse, but do not address the fundamental structural problems of the currency union—uneven current account balances and sharp divergence in labor costs as well as the lack of nominal GDP growth.

Despite these risks, we think the fundamental position of the US economy is much better today than it was a year ago. Household cash flows have improved owing to more consistent and stronger job creation, a sharp reduction in household financial obligations and lower commodity prices—especially energy prices. The US economy is also being propelled by strong profits and cash at corporations, while better finances at state and local governments should result in less of a drag from this sector. History shows that economic recoveries can be sustained even if some headwinds persist. Moreover, some of the imbalances facing the economy tend to lessen as nominal GDP expands and the recovery gains speed and breadth. ■

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## AllianceBernstein US Economic Forecast

December 2011

Levels (2005 Dollars Billion)	Quarterly					Annual			
	4Q10	1Q11	2Q11	3Q11	4Q11	2008	2009	2010	2011
Real GDP	13337.8	13442.2	13549.2	13671.2	13786.2	12703.1	13088.0	13319.9	13722.5
Consumption	9446.5	9515.4	9571.4	9618.4	9666.4	9037.5	9220.9	9432.8	9641.9
Durables	1277.1	1320.0	1325.0	1330.0	1335.0	1108.3	1188.3	1283.7	1333.8
Nondurables	2073.2	2087.0	2095.0	2112.0	2125.0	1983.4	2041.3	2078.1	2118.0
Services	6109.8	6122.0	6165.0	6190.0	6220.0	5935.5	5991.8	6084.5	6203.8
Investment									
Nonresidential Structures	331.6	335.0	338.0	345.0	350.0	367.3	309.1	323.6	347.0
Nonresidential Equip & Software	1144.3	1160.0	1180.0	1195.0	1215.0	889.7	1019.4	1123.7	1205.0
Res Structures	325.7	330.0	335.0	342.0	352.0	345.6	330.8	325.3	347.3
Change in Inventories	-8.5	12.0	15.0	25.0	40.0	-145.0	58.8	22.9	30.0
Net Exports	-400.7	-400.0	-390.0	-365.0	-355.0	-358.8	-421.8	-410.4	-362.5
Exports	1783.6	1810.0	1835.0	1875.0	1905.0	1494.0	1663.2	1777.1	1888.8
Imports	2184.3	2210.0	2225.0	2240.0	2260.0	1852.9	2085.0	2187.4	2251.3
Government	2507.6	2498.5	2508.5	2519.5	2526.5	2539.6	2556.8	2507.1	2522.5

Percent Changes	Quarterly % SAAR					% 4Q/4Q				Annual			
	3Q11	4Q11	1Q12	2Q12	3Q12	2009	2010	2011	2012	2009	2010	2011	2012
Real GDP	2.0%	3.2%	3.2%	3.7%	3.4%	-0.5%	3.1%	1.7%	3.3%	-3.5%	3.0%	1.8%	3.0%
Consumption	2.3%	2.9%	2.4%	2.0%	2.0%	-0.2%	3.0%	2.0%	2.1%	-1.9%	2.0%	2.3%	2.2%
Durables	5.5%	14.1%	1.5%	1.5%	1.5%	3.0%	10.8%	6.2%	1.9%	-5.4%	7.2%	8.0%	3.9%
Nondurables	-0.7%	2.7%	1.5%	3.3%	2.5%	0.6%	3.5%	0.9%	2.5%	-1.8%	2.9%	1.8%	1.9%
Services	2.9%	0.8%	2.8%	1.6%	2.0%	-0.9%	1.6%	1.6%	1.9%	-1.4%	0.9%	1.5%	2.0%
Investment													
Nonresidential Structures	12.6%	4.2%	3.6%	8.5%	5.9%	-29.2%	-1.8%	5.3%	6.0%	-21.2%	-15.8%	4.7%	7.2%
Nonresidential Equip & Software	15.6%	5.6%	7.1%	5.2%	6.9%	-5.8%	16.6%	9.0%	6.0%	-16.0%	14.6%	10.2%	7.2%
Res Structures	1.6%	5.4%	6.2%	8.6%	12.2%	-12.9%	-6.3%	2.1%	9.1%	-22.2%	-4.3%	-1.7%	6.7%
Net Exports													
Exports	4.3%	6.1%	5.6%	9.0%	6.6%	-0.1%	8.8%	5.4%	7.2%	-9.4%	11.3%	6.8%	6.3%
Imports	0.5%	4.8%	2.7%	2.7%	3.6%	-6.5%	10.7%	3.7%	3.2%	-13.6%	12.5%	4.9%	2.9%
Government	-0.1%	-1.4%	1.6%	1.8%	1.1%	1.1%	0.1%	-2.1%	1.5%	1.7%	0.7%	-1.9%	0.6%
Domestic Demand	1.5%	3.3%	2.8%	2.8%	3.0%	-1.5%	3.6%	1.6%	2.8%	-4.4%	3.4%	1.6%	2.6%

Key Macro Indicators	Quarterly					Annual			
	3Q11	4Q11	1Q12	2Q12	3Q12	2009	2010	2011	2012
Nominal GDP (Levels)	15180.9	15369.1	15567.3	15805.3	16025.4				
%QoQ SAAR	4.6%	5.1%	5.3%	6.3%	5.7%				
%YoY	3.9%	4.2%	4.7%	5.3%	5.6%	-2.47%	4.22%	4.00%	5.24%
Industrial Production (Index)	94.1	95.4	96.4	97.8	99.0				
%QoQ SAAR	5.3%	5.6%	4.3%	5.9%	5.0%				
%YoY	3.4%	4.0%	3.9%	5.3%	5.2%	-11.2%	5.3%	4.2%	4.8%
Housing Starts (Millions)	0.61	0.60	0.63	0.64	0.68	0.55	0.58	0.59	0.66
Industry Auto Sales (Millions)	12.4	13.3	13.2	13.5	13.7	10.4	11.6	12.7	13.6
Personal Savings Rate	3.8%	5.0%	5.0%	5.0%	5.0%	5.2%	5.3%	4.7%	5.0%
Unemployment Rate	9.1%	8.9%	8.7%	8.6%	8.5%	9.3%	9.6%	9.0%	8.5%
Operating Profits (%YoY)	7.9%	7.7%	8.5%	6.6%	4.4%	9.1%	32.2%	8.2%	6.0%
After-Tax Profits (%YoY)	11.4%	7.7%	9.0%	5.8%	2.7%	16.0%	27.5%	9.8%	5.3%

Inflation (% QoQ SAAR)									
GDP Deflator	2.5%	1.9%	2.0%	2.5%	2.2%	1.1%	1.2%	2.2%	2.2%
Consumer Price Index	3.1%	1.2%	2.0%	2.7%	2.3%	-0.3%	1.6%	3.2%	2.3%

Key Interest Rates (End of Period)									
Federal Funds Rate	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%
Three-Mo T-Bill (BEY)	0.02%	0.10%	0.10%	0.10%	0.10%	0.06%	0.12%	0.10%	0.10%
Two-Yr Note	0.25%	0.30%	0.30%	0.50%	0.60%	1.14%	0.61%	0.30%	0.70%
10-Yr Note	1.92%	2.10%	2.25%	2.50%	2.75%	3.85%	3.30%	2.10%	3.00%
30-Yr Bond	2.90%	3.10%	3.25%	3.75%	4.00%	4.63%	4.34%	3.10%	4.00%

Source: AllianceBernstein