

Weekly Economic Commentary



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What's The Consensus?

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Highlights

- A busy week of economic data and events in the United States and abroad will again play second fiddle to debt talks in the U.S.
- What is the consensus for the U.S. and global economies in the second quarter of 2011, the rest 2011, and 2012?

Economic Calendar

Monday, July 25 Dallas Fed Mfg. Index <i>Jul</i>	Thursday, July 29 GDP Price Index <i>Q2</i>
Tuesday, July 26 New Home Sales <i>Jun</i>	Real GDP <i>Q2</i>
Consumer Confidence <i>Jul</i>	Employment Cost Index <i>Q2</i>
Richmond Fed Mfg. Index <i>Jul</i>	Chicago PMA <i>Jul</i>
Wednesday, July 27 Durable Goods Orders <i>Jun</i>	U of Mich Consumer Sentiment <i>Jul</i>
Beige Book	
Thursday, July 28 Initial Claims <i>wk 07/23</i>	
Pending Home Sales <i>Jun</i>	

This week (July 25–29), the global economic and policy calendar really heats up after a relatively quiet week last week. Of course, until a resolution on raising the debt ceiling in the United States is reached (the deadline is August 2), market participants will be focused on Washington rather than on the economic data. In addition, another 175 S&P 500 companies will report their second quarter results this week, and these earnings reports may also divert attention away from Washington, at least temporarily.

In the United States, the Federal Reserve's (Fed) Beige Book (a qualitative assessment of economic and business conditions in each of the 12 Fed districts) and the second quarter report on gross domestic product (GDP) will get the most attention from the financial media, but regional manufacturing reports for July, the June durable goods report, and, of course, jobless claims could also be market movers. Overseas, India's central bank meets to set policy, as does the Reserve Bank of New Zealand. Many emerging market central banks, as well as central banks of developed economies with heavy exposure to commodities, are still raising rates to combat booming growth and accelerating inflation. Although China may hike rates again at any time, and Brazil raised rates for the fifth time since early 2010 last week, many overseas central banks are likely much closer to the end of their tightening cycles than they were in the early part of 2011.

It is expected to be a quiet week on the economic data front in China, with the next key data point being the release of the July purchasing managers index on July 31. However, a number of key reports on Japan's economy (industrial production, retail sales, construction) covering June will be released this week that should help markets gauge the pace of the recovery from the earthquake and tsunami. As noted in the section below, the Japanese earthquake and tsunami temporarily dampened economic activity in the United States in the second quarter of 2011, and the market expects that the reversal of these temporary factors will lift growth in the third quarter of 2011. Company specific data from Japan's automakers (released over the weekend of July 23–24) suggest that there was rapid improvement in the auto supply chain in June, which bodes well for a strong reading on June industrial production in Japan, which is due out on Friday, July 29.

At the start of 2011, the consensus (as measured by a survey of 65 economists by Bloomberg news) forecast for real GDP growth in the United States in 2011 was for growth of 3.1%. Today, that consensus forecast stands at just 2.5%. Our view today, as it was at the beginning of the year,

is that the United States economy will grow between 2.5 and 3.0% in 2011. Note that real GDP growth has averaged 2.8% since 1980. Thus, at the start of the year, we had a below consensus view of GDP growth in 2011, and today, our view is roughly in line with consensus. Interestingly, while we stuck to our view over the first six months of 2011, the consensus forecast rose (to as high as 3.2% by February 2011), and fell (to the aforementioned 2.5%) this year.

The consensus forecast for growth in 2012 in the United States stands at 3.0%, versus 3.2% in January 2011. By comparison, the Fed is expecting GDP growth to average 2.8% in 2011 and 3.5% in 2012. It is notable that both Fed forecasts are above the consensus. In our view, the Fed is more likely to lower than raise its forecast for economic growth in the coming months. The next Fed forecast is set to be released in November 2011.

Change in GDP Forecasts For 2011 Since the Beginning of the Year

	United States	Global	Developed Market Economies	Emerging Market Economies
Forecast Made in January 2011	+3.1%	+4.2%	+2.4%	+6.5%
Today's Forecast	+2.5%	+4.0%	+2.2%	+6.6%

Source: Bloomberg 07/25/11

Turning now to the outlook for global growth, we find that the consensus is looking for 4.0% GDP growth in 2011, only slightly below the 4.2% growth the consensus was expecting in January 2011. The key driver here remains growth in emerging market economies, which are expected to experience 6.6% growth in 2011 and 6.4% in 2012, roughly triple the forecast for the developed world (2.2% in 2011 and 2.6% in 2012). Strong GDP growth in emerging market economies—despite the many rate hikes implemented by most emerging market central banks over the past 18 months—continues to drive not only global GDP growth, but also U.S. exports and U.S. corporate profits. Merchandise trade data compiled by the United States Department of Commerce shows that around 50% of U.S. exports go to emerging market economies.

Taking a shorter-term view, the consensus estimate for U.S. economic growth in the second quarter of 2011 is for a 1.8% quarter-over-quarter gain in real GDP after a 1.9% quarter-over-quarter gain in the first quarter of 2011. The second quarter GDP data is due out on Friday, July 29, 2011. As is typically the case this time of year, the government agency that compiles the GDP data, the Bureau of Economic Analysis (BEA), will also release revised data on GDP and its components (consumer spending, exports, government spending, etc.) back to 2008. Some components will be revised back to early 2003. While the revisions to prior data won't change the investing landscape—after all, markets are forward looking, the data will be pored over by pundits, the media and politicians looking for ways to assign blame (or take credit) for the Great Recession and the recovery over the past two years.



Several temporary factors (severe weather, floods, and Japanese earthquake-related supply chain disruptions, high consumer energy prices) likely curtailed growth in the second quarter. While we expect these weights on growth to lift in the second half of the year and foster more rapid growth, several factors that weighed on growth in the first half of 2011 will continue to weigh upon growth in the second half of 2011 and beyond. Among these longer term issues are:

- Ongoing layoffs in state and local governments
- A moribund residential and commercial real estate market
- A tepid labor market
- Sagging business and consumer confidence

Until these longer term weights on growth are resolved, the prospects for economic growth in the United States are muted. In short, while the U.S. economy has experienced a relatively modest recovery—roughly in line with the recoveries from the mild recessions in the early 1990s and early 2000s—when compared to the severity of the Great Recession, the recovery does not “feel” like a real recovery. It is not likely, unfortunately, that the second quarter GDP report will change that view.

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Stock investing involves risk including loss of principal.

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Developed economies are typically described as a country with a relatively high level of economic growth and security. Some of the most common criteria for evaluating a country's degree of development are per capita income or gross domestic product (GDP), level of industrialization, general standard of living and the amount of widespread infrastructure. Increasingly other non-economic factors are included in evaluating an economy or country's degree of development, such as the Human Development Index (HDI) which reflects relative degrees of education, literacy and health.

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