Friday, January 27, 2012

Economy Climbing Back

Some air went out of investors' hopes today as the government reported lower-than-expected growth for the fourth quarter. Economists had projected a 3.0% increase. Still, the 2.8% pace represents the fastest growth for the economy since the second quarter of 2010. The government also said that consumer spending in the US rose 2% in the fourth quarter, improving the 1.7% rate of the third quarter and 0.7% in the second quarter. As the trading session gets started, stocks are mixed. Bonds remain higher.

Today's slower GDP report is favorable for bond holders because it implies less financial pressure on prices potentially resulting in higher inflation. But the best news bondholders could hope for came on Tuesday when the Federal Reserve, for the first time ever, announced its long-run target for inflation at 2%. They said "the inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee judges that inflation at the rate of 2%, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. Communicating this inflation goal clearly to the public helps keep longer-term inflation expectations firmly anchored, thereby fostering price stability and moderate long-term interest rates and enhancing the Committee's ability to promote maximum employment in the face of significant economic disturbances."

This is the kind of strong language bondholders love to hear. Whether the Fed will be able to sustain interest rates or not in the face of huge US deficits and debt, of course remains to be seen. If bond investors begin to perceive that inflation risk is rising, their demand for higher yields could swamp the Fed's efforts to restrain rates. When large bondholders, both domestic and foreign sell together as 'bond vigilantes' they wield powerful sway over the government's ability to over-spend and borrow.

The Fed also published for the first time the committees' views on when interest rates should rise: 3 members indicated it should be in 2012, 3 in 2013, 5 in 2014, 4 in 2015, and 2 in 2016. The Fed also weighed in with its own GDP growth projections for 2012: at 2.2% - 2.7%, 2013: at 2.8% - 3.2%, 2014: at 3.3% - 4.0% and longer run: 2.3% - 2.6%. November projections were about 0.2% higher and more across the board. Projections for unemployment were 8.2% - 8.5%, 7.4% - 8.1%, 6.7% to 7.7% for the next three years. These projections were marginally improved over November's projections.

Pending home sales fell 3.5% in December after a sharp increases or 7.3% and 10.4$ the prior two months. Annual pending home sales are up 5.6%, down 0.3% from November. According to Econoday, the trend looks good for home sales.

New home sales, unfortunately did not confirm the pending home trend as sales fell 2.2% to a low annual rate of 307,000 vs. the Econoday consensus for 320,000. The most notable decline was in the South, which is by far the largest and most important region in the report says Econoday. Supply of new homes on the market rose to 6.1 months. It was the first time in six months this reading failed to improve. The median price of new homes fell 2.5% to $210,300. On an annual basis, the median price is down 12.8% for the worst reading of the recovery.

Manufacturing continues to sustain and stimulate the broader economy. December's Durable Goods Orders increased by 3% following a 4.3% jump in November, surprising economists.

After removing the more volatile transportation results from the number, durables still rose a healthy 2.1% following 0.5% in November. Motor vehicles and non-defense aircraft were strong. Primary metals, machinery, computers, and electronics and communications equipment were major contributors.

In his State of the Union message President Obama challenged manufacturers to “ask yourselves what you can do to bring jobs back to your country.” David Lynch of Bloomberg challenges the notion saying that “factory jobs, which have been shrinking as a share of total US employment since the early 1950s, remain 2 million below their pre-recession level. Obama’s election-year plan ‘to bring manufacturing back,’ as well as a rival House Republican package that would reduce taxes and prune regulations -- fly in the face of structural changes that inexorably lower employment in goods-producing industries.”

He goes on to say “with each year, technology allows factories to produce more goods with the same number of, or fewer, workers. Since the landmark 1994 North American Free Trade Agreement, NAFTA (remember Ross Perot’s ‘giant sucking sound?’) US factory workers also have faced increasingly vigorous competition from low-wage countries. That one-two punch drove manufacturing jobs from their 1979 peak of 19.5 million to today’s 11.8 million even as industrial output almost doubled.

Gene Sperling, head of the White House National Economic Council says “we believe manufacturing punches above its weight economically. The strength of your advanced manufacturing is critical to your innovation as a country.”

In his article, David Lynch quotes Keith Nosbusch, chief executive officer of Rockwell Automation as saying “the government must cut taxes and regulation, curb the increase in health-care costs and deliver relief from frivolous lawsuits. US manufacturers suffer from a ‘‘structural cost disadvantage’’ and highly-automated US factories require fewer workers. Yet even leaner operations have spillover effects on hiring beyond the factory gates.”

‘‘Manufacturing still has the highest leverage factor of any sector. It creates much more value and many more ancillary jobs than any other sector,’’ Nosbusch said. ‘‘That’s why it’s so critical. It’s not about just what is the direct manufacturing population, but do you have a competitive manufacturing environment so that you are able to create those indirect jobs that support automated manufacturing.’’

It looks like we will be hearing more “Made in America” as the presidential campaign begins in earnest. Should be interesting to see from both sides how their plans will incorporate healthcare, regulations, and tax incentives.

Have a nice weekend.

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