

Insight on the U.S. Economy

Vassilis Dagioglu

Managing Director,
Head of Asset Allocation Portfolio Management

Karsten Jeske, Ph.D., CFA

Vice President,
Research

Anil Vijendran

Portfolio Manager,
Asset Allocation

Summary

Against the overall gloomy economic backdrop, in our view the U.S. appears to have continued an economic recovery in 2011. In this article, we assemble and examine various pieces of economic data to evaluate the resilience of the U.S. economy.

Business investment, consumption, imports, and exports have staged a recovery following the 2008-09 recession. Business sentiment, as measured by various surveys¹, also paints a picture of recovery, and of gradually improving confidence. Some aspects of the recovery, however, continue to remain fragile. The labor market has recently shown signs of improvement but is in the process of a gradual structural realignment. The overhang of the housing downturn continues to be a drag on residential investment, which historically has been a strong driver of growth post recession. Recent improvements in consumer confidence are a positive development but the various confidence indices continue to be far below their pre-recession peaks.

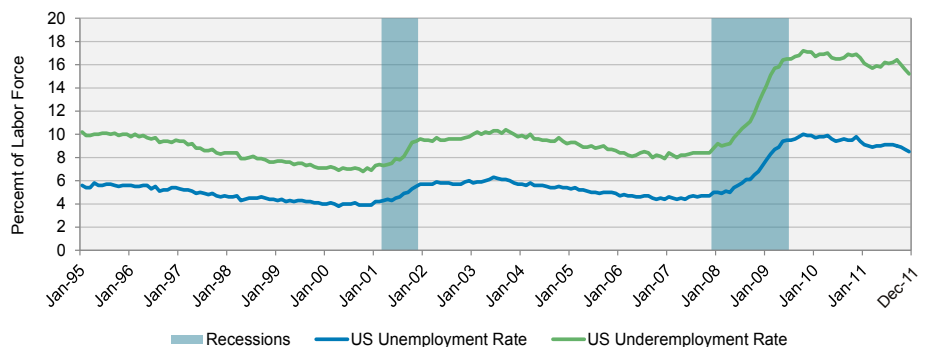
Mellon Capital’s proprietary point forecast for real GDP over the next twelve months stands at 2.6%, supported by the solid recent macroeconomic indicator readings (Institute of Supply Management, employment, vehicle sales). While slightly more optimistic than the Consensus Economics forecast of 2.2%, our forecast still keeps the near-term growth path of U.S. GDP well below the pre-crisis levels, consistent with the structural impediments of the weak housing market and the moderate recovery in employment.

Labor

The headline unemployment rate has stabilized and is marginally starting to trend down.

Figure 1: U.S. Unemployment Rate
January 31, 1995 –
December 31, 2011

Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics

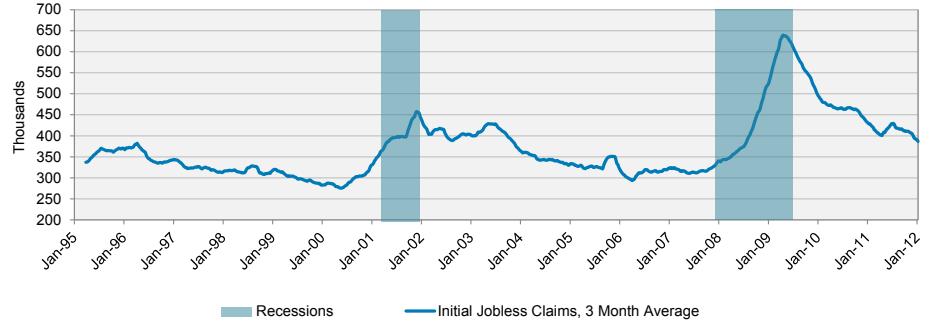


¹ Institute for Supply Management and Purchasing Managers Index (ISM PMI), National Federation of Independent Business Index (NFIB)

Initial jobless claims support the improvement in the unemployment rate.

Figure 2: Initial Jobless Claims, 3 month Average
January 6, 1995 – January 13, 2012

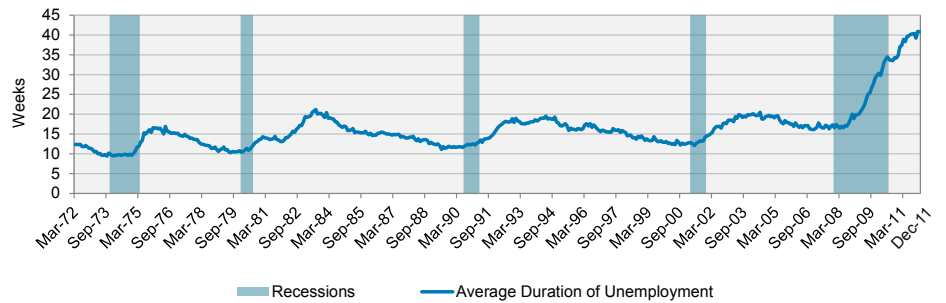
Data sources: Bloomberg, U.S. Department of Labor: Employment and Training Administration



However, despite the drop in the headline unemployment rate, the average duration of unemployment has doubled to 40 weeks since the start of the most recent recession. A significant proportion of those unemployed have been so for at least 27 weeks.

Figure 3: Average Duration of Unemployment
March 1, 1972 – December 1, 2011

Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



The drop in the labor force participation rate signals that the improvement in the unemployment rate is, to a large extent, due to a significant part of the population exiting the labor force.

Figure 4: Labor Force Participation Rate
January 31, 1995 – December 31, 2011

Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



Improvement in employment is simply keeping up with population growth.

Figure 5: U.S Employment to Population Ratio
January 1, 1995 – December 31, 2011

Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



Job openings have improved significantly from recent depths of August 2009.

Figure 6: Job Openings
December 31, 2000 – November 30, 2011

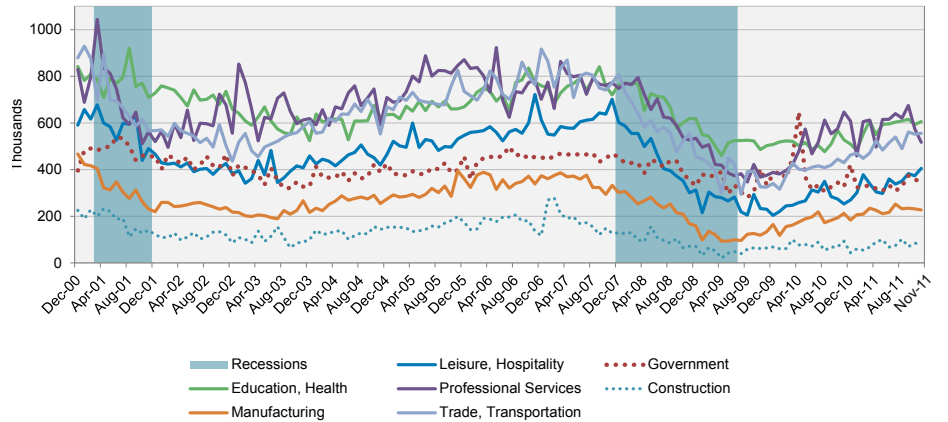
Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



However, we are not uniformly gaining back jobs lost across sectors. Manufacturing, construction, and government sectors are seeing a much slower recovery than education, health, hospitality, professional services, and trade and transportation.

Figure 7: Job Openings by Sector
December 31, 2001 – November 30, 2011

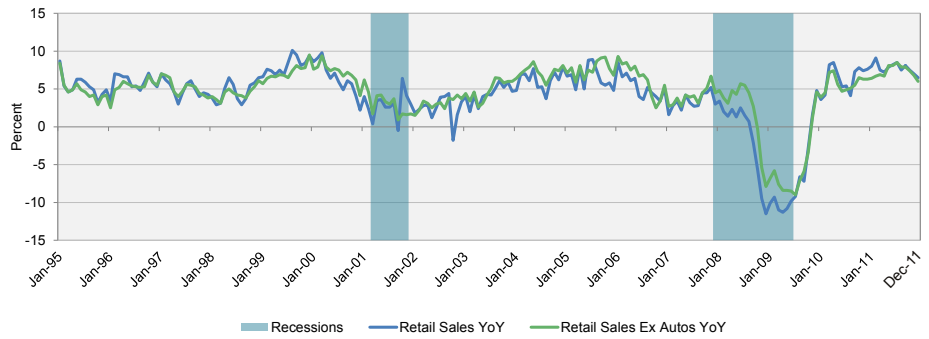
Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



Consumer Demand

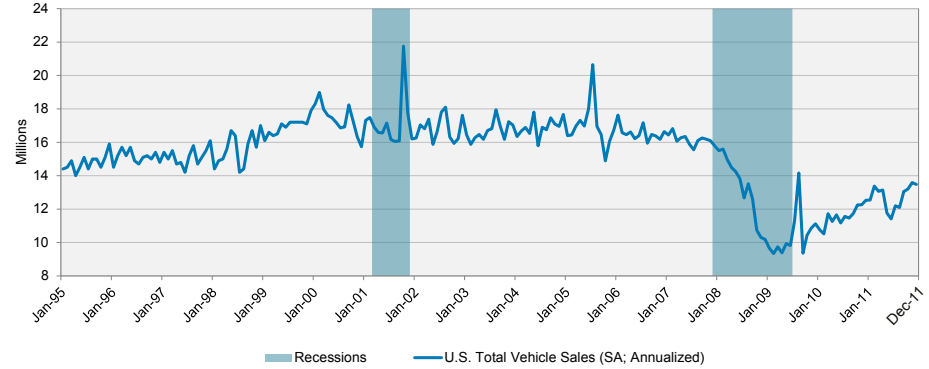
After a deep correction during the recession, growth in retail sales has recovered back up to the pre-recession trend.

Figure 8: U.S. Retail Sales, Year over Year (YoY)
 January 31, 1995 2001 – December 31, 2011
 Data sources: Bloomberg, U.S. Department of Labor: Bureau of Labor Statistics



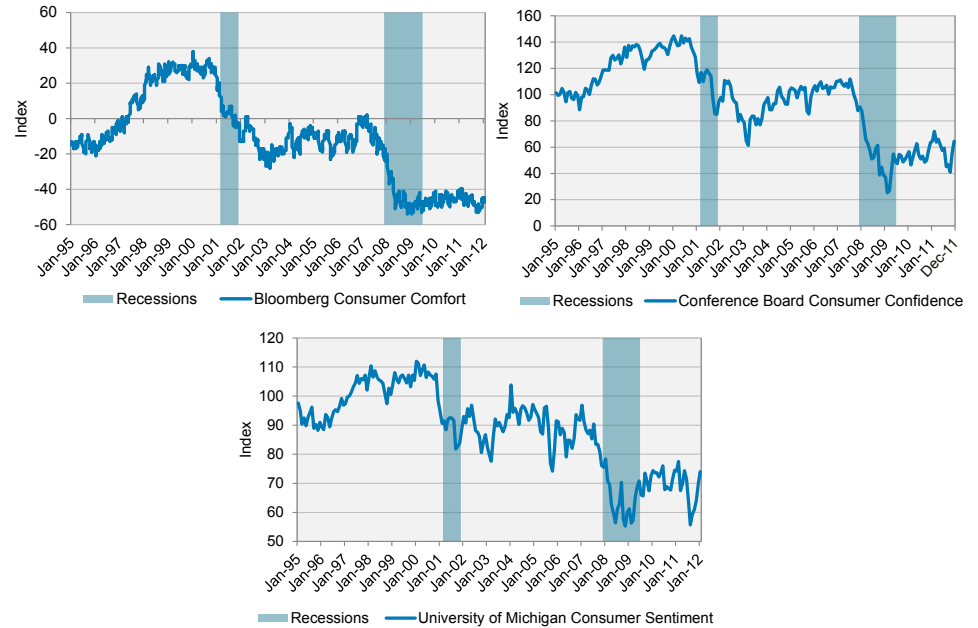
Vehicle sales appear to be well on their path to recovery, especially after the Japan earthquake/tsunami drop of March 11, 2011. Over the past two months vehicle sales have been strongest since the recession and excluding the “Cash for Clunkers” in July and August 2009.

Figure 9: U.S. Total Vehicle Sales
 January 31, 1995 – December 31, 2011
 Data sources: Bloomberg, U.S. Department of Labor: Bureau of Economic Analysis



Consumer confidence as measured by some indicators has recovered from recession lows but is still far below pre-recession peaks.

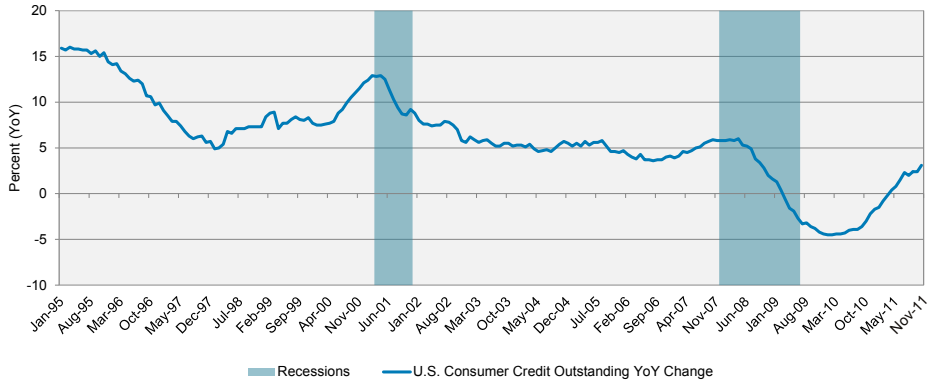
Figure 10: Consumer Confidence
 Data sources: Bloomberg (January 1, 1995 - January 15, 2012), The Conference Board (January 31, 1995 - December 31, 2011), Reuters/University of Michigan (January 31, 1995 - January 31, 2012)



Consumer credit, which includes credit cards and auto loans, has seen a steady pick up signaling that consumers are confident enough to take on additional loans and the banking system is making more credit available for borrowers.

Figure 11: U.S. Consumer Credit Outstanding Year over Year (YoY) Change
January 31, 1995 – November 30, 2011

Data sources: Bloomberg, Board of Governors of the Federal Reserve System

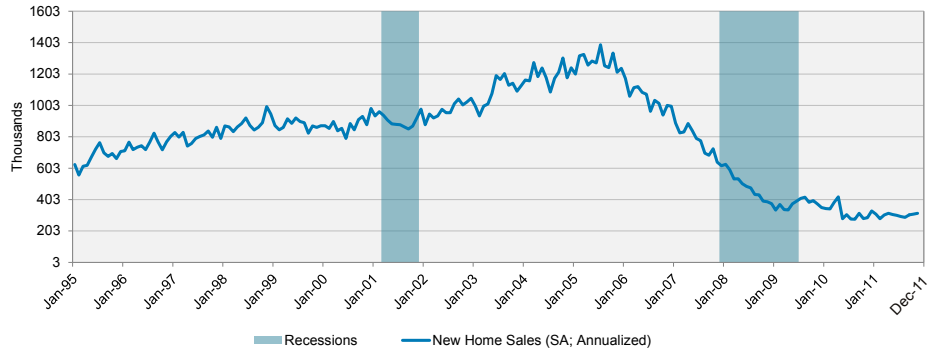


Housing

Existing and new home sales have stabilized with no clear upward momentum.

Figure 12: New Home Sales and Existing Home Sales
January 1, 1995– December 31, 2011

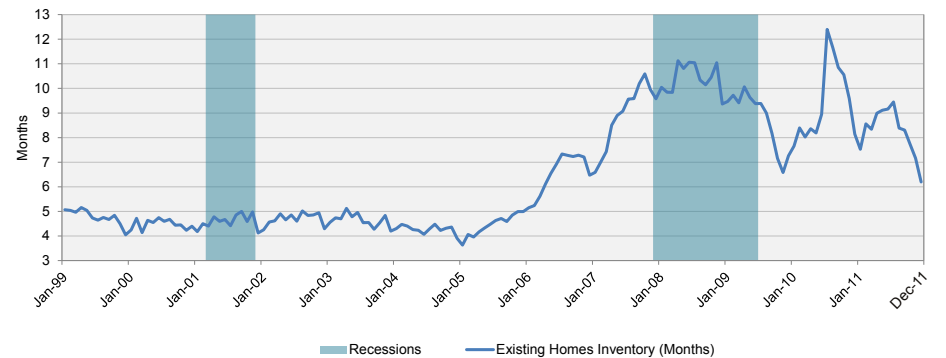
Data sources: Bloomberg, U.S. Department of Commerce: Census Bureau



The level of existing homes inventory is declining and is currently at around seven months, assuming monthly sales from November. Inventory has recovered back to the levels reached in response to the first-time home buyer tax credit in 2009.

Figure 13: Existing Homes Inventory
January 31, 1999– December 31, 2011

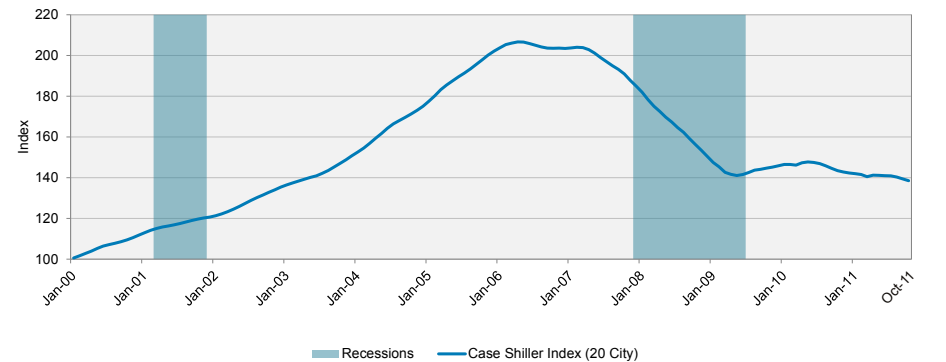
Data source: Bloomberg



Home prices have yet to recover nationally.

Figure 14: Case Shiller 20-City Index
January 31, 2000– October 31, 2011

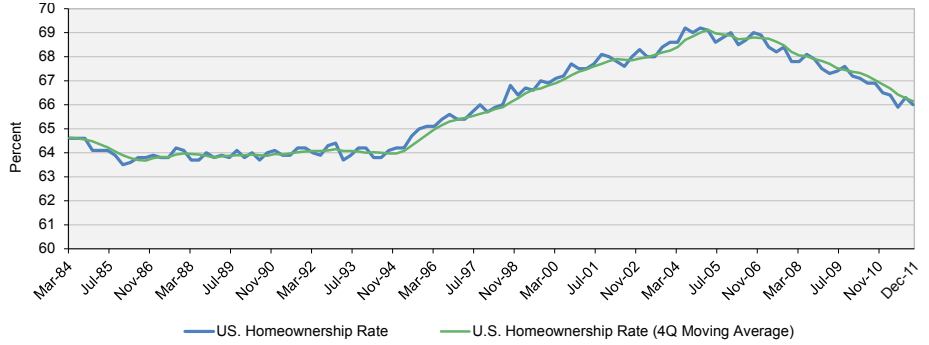
Data source: Bloomberg



Home ownership rate appears to be in a steady decline.

Figure 15: U.S. Home Ownership Rate
 March 30, 1984–
 December 30, 2011

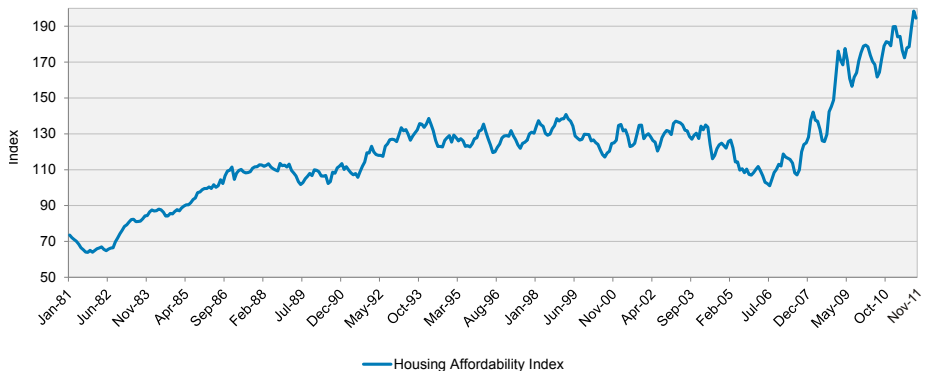
Data sources: Bloomberg, U.S. Department of Commerce: Census Bureau



Housing affordability is at a record high but excess inventory, a weak job market, and tighter lending standards continue to weigh on home prices and sales.

Figure 16: Housing Affordability Index
 January 1, 1981–
 November 1, 2011

Data sources: Bloomberg, National Association of Realtors

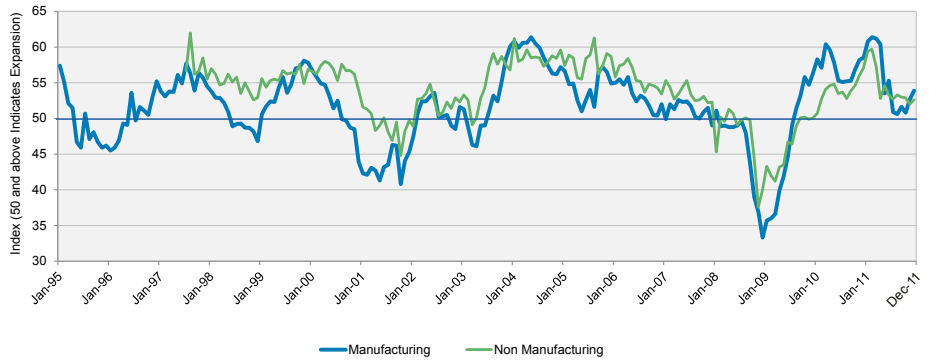


Business Sentiment

Both the manufacturing and non-manufacturing purchasing managers' index (PMI) as reported by the Institute for Supply Manufacturing (ISM) have been in the expansion region since 2010. Recent ISM reports in January continue the upbeat trend and show broad gains in many of the subcomponents of the PMI.

Figure 17: Purchasing Managers' Index
 January 31, 1995–
 December 31, 2011
A level above 50 signals expansion

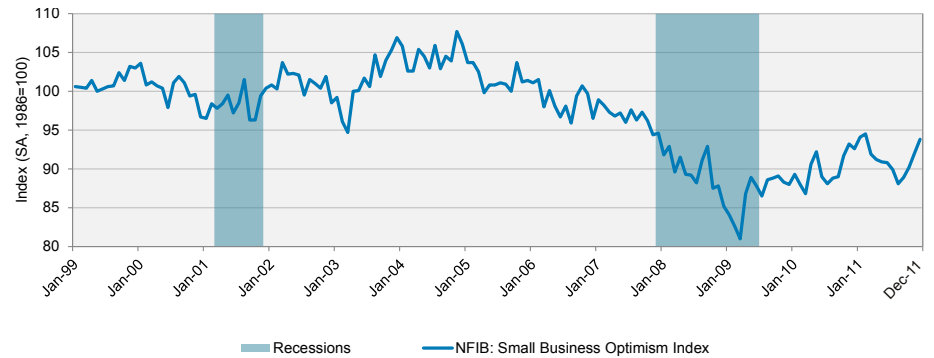
Data sources: Bloomberg, Institute for Supply Management



The National Federation of Independent Business Index of small business confidence has recovered from its recession lows and from the August 2011 confidence shocks due to the debt ceiling debate and the S&P downgrade of U.S. debt in 2011.

Figure 18: NFIB: Small Business Optimism Index
January 31, 1999–December 31, 2011

Data sources: Bloomberg, National Federation of Independent Business

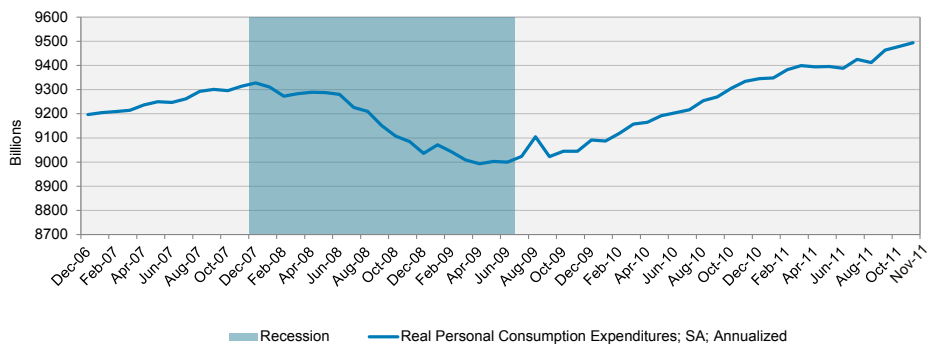


Components of U.S. GDP

In Q3 2011, real personal consumption, the largest single component in overall GDP, grew by an annualized rate of 1.7%. Consumption has rebounded back to pre-recession levels.

Figure 19: Real Personal Consumption Expenditures; Seasonally Adjusted at Annual Rates
December 1, 2006–November 1, 2011

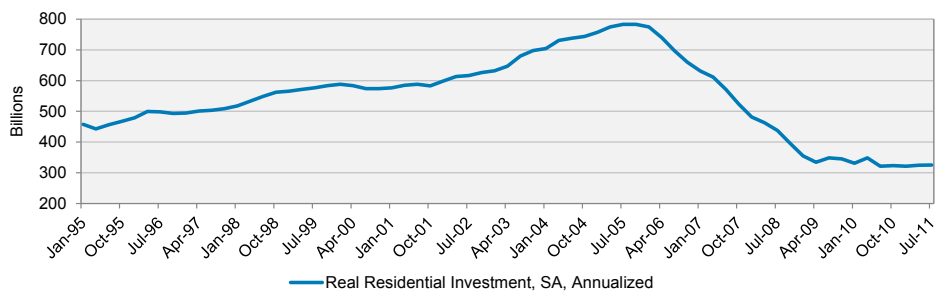
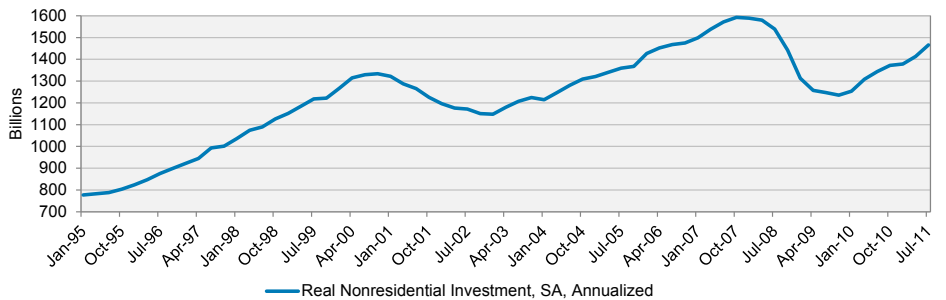
Data sources: Bloomberg, U.S. Department of Commerce: Bureau of Economic Analysis



Nonresidential fixed investment has picked up, but residential fixed investment, normally a candidate for a strong rebound during expansions, has continued to stagnate well below pre-recession levels.

Figure 20: Real Nonresidential and Real Residential Investment; Seasonally Adjusted at Annual Rates
January 1995–July 1, 2011

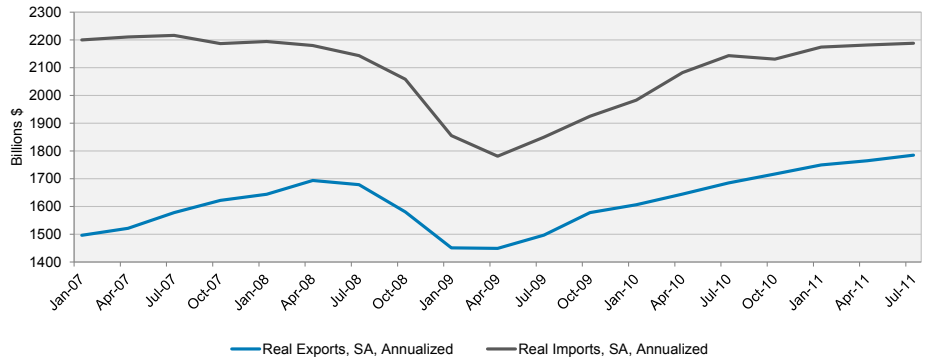
Data sources: Bloomberg, U.S. Department of Commerce: Bureau of Economic Analysis



Both imports and exports have rebounded from their recession lows and exports are higher than the pre-recession peak. The strength of the U.S. Dollar and a contraction in the Euro area pose significant risks to U.S. exports.

Figure 21: Real Exports and Real Imports; Seasonally Adjusted at Annual Rates
January 1 1995– July 1, 2011

Data sources: Bloomberg, U.S. Department of Commerce: Bureau of Economic Analysis

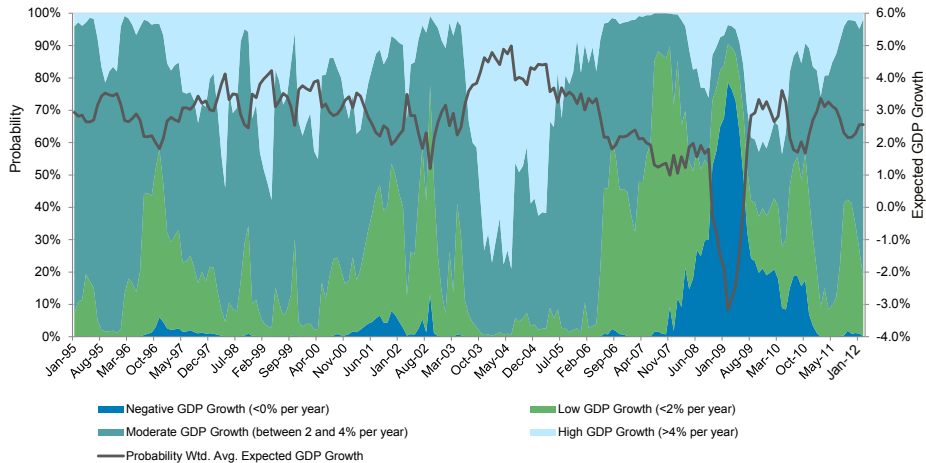


Mellon Capital Management Forecast

Mellon Capital's proprietary point forecast for real GDP over the next twelve months stands at 2.6%, supported by the solid recent macroeconomic indicator readings (ISM, employment, vehicle sales). The highest probability (80%) lies in the 2-4% region. The model assigns a 17% probability to real growth between 0 and 2%, and a 2% probability of growth above 4%. The model finds it highly unlikely (<1%) that year-over-year growth will drop to below 0%.

Figure 22: U.S. GDP Growth Expectations for One-Year Ahead GDP
January 31, 1995 – January 10, 2012

Data sources: Proprietary calculations of Mellon Capital utilizing Thomson Reuters Datastream





ABOUT US

Mellon Capital – Global. Insightful. Engaged. Mellon Capital has provided global multi-asset solutions for nearly thirty years. Our precise understanding of world markets, coupled with our fundamentals-based and forward-looking analytical methods are the foundation for tailored client solutions. Our investment capabilities range from indexing to alternatives with the infrastructure and skill to transact in all liquid asset classes and securities.

CONTACT INFORMATION

BUSINESS DEVELOPMENT
Sheryl Linck, Managing Director
412.234.9439
sheryll@mcm.com

CLIENT SERVICE
David Dirks, Managing Director
617.248.4562
davidd@mcm.com

CONSULTANT RELATIONS
Andy Pellegrino, Managing Director
412.234.1909
andyp@mcm.com

PRIMARY LOCATIONS

PITTSBURGH, PA
BNY Mellon Center
500 Grant Street
Pittsburgh, PA 15258
412.234.7500

BOSTON, MA
BNY Mellon Center
201 Washington Street
Boston, MA 02108
617.248.4500

SAN FRANCISCO, CA
HEADQUARTERS
San Francisco
50 Fremont Street
Suite 3900
San Francisco, CA 94105
415.546.6056

ONLINE
www.mcm.com

This publication reflects the opinion of the authors as of the date noted and is subject to change without notice. The information in this publication has been developed internally and/or obtained from sources we believe to be reliable; however, Mellon Capital Management Corporation does not guarantee the accuracy or completeness of such information. This publication is provided for informational purposes only and is not provided as a sales or advertising communication nor does it constitute investment advice or a recommendation for any particular investment product or strategy for any particular investor. Economic forecasts and estimated data reflect subjective judgments and assumptions and unexpected events may occur. Therefore, there can be no assurance that developments will transpire as forecasted in this publication. Past performance is not an indication of future performance.

Mellon Capital Management and its abbreviated form Mellon Capital are service marks of Mellon Capital Management Corporation.

No part of this article may be reproduced in any form, or referred to in any other publication without express written permission of Mellon Capital.