



Orlando's Outlook: Trade data point to strengthening economy

As of 11-11-2011

Bottom line *Despite the ongoing European sovereign debt crisis and fears of a Chinese economic hard landing, U.S. companies exported a record \$180.4 billion in goods and services in September (a healthy 1.4% gain from August), which surprisingly drove the monthly trade deficit down to its lowest level of the year at \$43.1 billion. That could very well result in a positive revision for third-quarter Gross Domestic Product (GDP)—which had originally posted a solid flash gain of 2.5%—when the Commerce Department issues its first revision on Tuesday, November 22. Importantly, companies were extremely cautious with their inventory levels during the third quarter, particularly in light of widespread double-dip recession fears. Consequently, wholesale inventories actually declined in September for the first time in nearly two years, which placed a sizable drag on third-quarter GDP. But end-market demand heading into the fourth quarter is relatively strong with very lean inventory levels, a combination that could spark the commencement of an inventory restocking cycle into year end and result in sequentially stronger fourth-quarter GDP gains. To be sure, U.S. exports have clearly benefitted from strong foreign demand and the weak dollar, so we'll be watching closely to see if the economic woes in Europe or Asia have a deleterious impact on domestic economic growth.*

When we first established our temporary economic soft-patch thesis back in April, it was chiefly predicated on the supply-chain disruptions we anticipated from Japan in the aftermath of the tragic earthquake and tsunami. But we also felt that as Japan's economy came back on line, perhaps as early as the second half of this year, then those transitory issues would begin to fade from view, resulting in improved economic growth in the U.S. In fact, quarterly GDP growth has risen this year from its trough at 0.4% in the first quarter, to 1.3% in the second quarter, to a preliminary gain of 2.5% in the third quarter and finally to a level that may be prospectively equal to or higher than that in the fourth quarter. So the U.S. economy, in our view, is strengthening from a temporary soft patch, not rolling over into a double-dip recession.

Here are some additional observations regarding improving trade trends and stronger economic growth:

Auto sales rebounding Total vehicle sales in the U.S. in April had peaked at 13.14 million annualized units, before the supply-chain disruptions in Japan began to have any negative impact. But by June, they had plunged by more than 13% to a trough of 11.41 million units. Over the next four months, however, as Japanese production has begun to come back on stream, October sales have surged by almost 16% to 13.2 million units. We expect that this positive trend has legs, as vehicle financing is as good today as it's been in almost five years, and because domestic replacement demand is estimated at about 14.0 million units, which should continue to drive improving GDP growth.

Manufacturing orders turn up After sloppy to negative order trends over the summer months, factory orders have now surprisingly turned positive in each of the past three months, durable goods orders ex-transportation rebounded nicely in September from negative August readings, and capital goods orders for non-defense ex-transportation products accelerated in September over tepid August levels, all of which we believe may accelerate into year end.

Accelerated depreciation may be a factor Aside from improving macroeconomic fundamentals, there is an accelerated depreciation law on the books that expires at year end, which may spark a budget flush to capture a tax benefit. True, Congress is considering whether to extend the tax break into 2012. But given the uncertainty surrounding the Super Committee's deliberations, and the timing of their submission of their proposal to the full Congress by Thanksgiving, Congress' up-or-down vote by Christmas, and the president's subsequent signing the bill into law in January, companies may not want to risk losing the 100% write-off of capital expenditures.

Manufacturing payrolls and hours improve Manufacturing added 5,000 jobs during October for the first time in three months, while September's preliminary manufacturing loss of 13,000 jobs was revised to a more modest loss of only 3,000 jobs and the revised decline of 4,000 jobs in August was revised again to a final loss of only 1,000 jobs. In addition, the manufacturing work week, which is one of the 10 components of the Leading Economic Indicators (LEI), rose to 40.5 hours in October from 40.3 in September. This metric is important, because each 0.1 hour worked is the equivalent of adding an estimated 400,000 jobs.

Weekly jobless claims accelerate their decline Initial weekly jobless claims fell to their lowest level in seven months last week at 390,000 for the week ended November 5, compared with this year's cycle low on April 2 at 385,000. Weekly claims have now held either just above or below the critical 400,000 mark for seven consecutive weeks, and the four-week moving average, which is considered a less volatile measure of unemployment, fell to 400,000 last week, also the lowest

reading since last April. We still need to see weekly claims drop sustainably below the 400,000 level to signal that a much stronger employment market has taken hold, but this important leading employment indicator supports the moderate improvement we have seen in the labor market over the past few months.

Michigan confidence rises The preliminary November reading for the Thomson Reuters/University of Michigan consumer confidence survey surprisingly jumped to 64.2, which is the highest level since June, compared with estimates for a more conservative reading of 61.5 and October's final reading of 60.9. We believe that this improved level of confidence is a lagged response to the steady improvement we have seen lately in the labor market, which is critically important heading into the holiday shopping season.



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Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

The Conference Board's Composite Index of Leading Economic Indicators is used to predict the direction of the economy's movements in the months to come.

The University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone

survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

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