Outlook and Market Review – Fourth Quarter 2011

Based on preliminary estimates from the Bureau of Economic Analysis, the economy grew only 1.7% in 2011 following 3% growth in 2010. For the fourth quarter of 2011, the preliminary economic growth estimate was 2.8% but roughly two-thirds of that growth came from inventory accumulation. Consumer savings rates picked up in the fourth quarter as consumer spending was more in line with income than in prior quarters. While fixed investment slowed, residential investment improved. Both government and exports were drags on the economy in the fourth quarter and this trend is likely to continue. Fiscal stimulus has run its course and the focus is on lowering trillion dollar annual deficits and slowing the inevitable march to a sixteen trillion dollar public debt. The severe weakness of the European economies will take the edge off U.S. export demand and could present a larger drag on what is already a low economic growth.

Weak government spending reduced GDP growth by about 1 percent in the fourth quarter. Spending reductions and belt-tightening at all levels of government will remain a drag on the economy. Without fiscal stimulus, growth must be led by consumers and private investment, which will be difficult until job creation picks up dramatically and housing prices begin a sustained upward trend. The political winds are currently blowing in the direction of income distribution issues, but if the elections bring a focus on household wealth creation, we may see a needed overhaul of the tax and regulatory system. Such a shift would offer upward revisions to longer term GDP growth. The Fed is committed to a low interest rate environment through 2013 and most of 2014 to allow for ample liquidity and credit availability if private sector demand takes hold. Relatively low inflation pressure provides room for continued monetary stimulus in the near term, but the Fed can't "push on a string." Stronger business and consumer demand must be forthcoming.

The Federal Reserve Bank estimate of GDP growth for 2012 is 2.5%, which is close to the 2.4% forecast from the Survey of Professional Forecasters. Based on the CPI, the 3% inflation rate in 2011 exceeded the Fed's 2.5% target, but inflation pressures eased in the last part of 2011 with downward pressures on energy and commodity prices. Most analysts expect unemployment to reverse its current downward path and tick back up in 2012 due to higher labor force participation. Job growth coming out of 2011 has been surprisingly strong with unemployment dipping to 8.3%, strong job growth and a reduction of jobless claims to a four year low in January. Production and manufacturing data suggest upturns going into 2012. On the downside, there are serious risks in the global economy. The European debt crisis is not likely to be resolved without continued austerity and downward pressures on fiscal spending. If Europe goes over the edge it will bring the U.S. down with it to some degree based on

trade, banking exposure and sinking sentiment. Other wild card risks include escalated conflict with Iran over its nuclear program and escalated turmoil in the Middle East from the "Arab Spring."

Without major geopolitical shocks, the U.S. economy should achieve growth in the 2.4% to 2.6% range with continued low interest rates. If inflation rates remain at the 2% to 2.5% rate and below, we should see 10-year Treasury securities with a 1.8% to 2.1% yield and a near zero rate on short term Treasuries. These "negative real interest rates" should promote investing and spending later in the year as the delevering phase ends for households and job growth builds. Credit risk premiums will expand if the economy underperforms the expected targets or if either Europe or the Middle East turns worse. Unemployment is likely to be about 8.5% at the end of the year unless an unexpected increase occurs in the labor force, which would tilt the unemployment rate higher. This scenario is slightly more optimistic than the consensus of professional forecasters.

The Survey of Economic Forecasters – *Low growth and high unemployment will persist through 2012. An expected recession in Europe will create a drag on U.S. growth and consumers are not positioned to drive a strong recovery.*

The Survey of Economic Forecasters is based on estimates by 45 professional economists reporting to the Federal Reserve Bank of Philadelphia. The forecasts summarized below are January 2012 estimates that are generally more pessimistic than the survey results provided in August of 2011. Overall the forecasters predict real GDP growth of 2.4 percent in 2012 and 2.7 percent in 2013. Unemployment is projected to average 8.8 percent in 2012 before falling to 8.4 percent in 2013 and 7.8 percent in 2014. On the employment front, forecasters see an annual average monthly rate of nonfarm payroll employment of 123,200 in 2012. The forecasts of GDP, unemployment rate and payrolls are provided in Table A for quarterly data and Table B for annual data. Downward revisions are noted in red.

Table A. Quarterly Forecasts of GDP, Unemployment Rate and Payroll Growth

	Real GDP (%)		**Unemployment Rate (%)**		**Payroll (000s per**	
	Previous Forecast	**Current Forecast**	**Previous Forecast**	**Current Forecast**	**Previous Forecast**	**Current Forecast**
2012 1st Qtr	2.2	2.4	8.8	**8.9**	180.3	**121.0**
2012 2nd Qtr	2.9	**2.4**	8.7	**8.9**	138.0	**126.3**
2012 3rd Qtr	3.2	**2.8**	8.6	**8.8**	187.0	**152.4**
2012 4th Qtr	N.A.	2.7	N.A.	8.7	N.A.	126.3
month)						

Source: Survey of Economic Forecasters

Table B. Annual Forecasts of GDP, Unemployment and Payroll Growth

	Real GDP (%)		**Unemployment Rate (%)**		**Payroll (000s per month)**	
	Previous Forecast	**Current Forecast**	**Previous Forecast**	**Current Forecast**	**Previous Forecast**	**Current Forecast**
2012	2.6	**2.4**	8.6	**8.8**	150.1	**123.2**
2013	2.9	**2.7**	8.1	**8.4**		
2014	3.1	3.5	7.6	**7.8**		

Source: Survey of Economic Forecasters

Unlike estimates of GDP and unemployment, forecasts for inflation in 2012 and 2013 were not revised in the August estimates. Headline CPI inflation in 2012 is expected to average 1.9 percent and rise to 2.2 percent in 2013. Core CPI inflation in 2012 is expected to average 1.8 percent and edge up to 2.0 percent in 2013. The projections for headline and core PCE inflation follow a similar pattern. Over the following 10 years (2011 to 2020) the forecasters expect headline CPI inflation to average 2.5 percent at an annual rate. Over the same period, headline PCE inflation will average 2.16 percent at an annual rate. When taken as a whole, forecasters do not see much change in inflation pressures in the near term or in the longer term. Forecasts of inflation appear in Table C with upward revisions in red.

Table C. Forecasts and Revisions of the CPI and PCE

	Headline CPI		Core CPI		Headline PCE		Core PCE	
	Previous Forecast	Current Forecast	Previous Forecast	Current Forecast	Previous Forecast	Current Forecast	Previous Forecast	Current Forecast
Quarterly								
2012:Q1	2.0	2.0	1.6	**1.8**	1.8	1.7	1.5	**1.6**
2012:Q2	2.1	1.9	1.9	1.8	1.6	1.6	1.7	1.6
2012:Q3	2.0	2.0	2.0	1.8	1.8	1.8	1.7	1.7
2012:Q4	N.A.	2.0	N.A.	1.8	N.A.	1.7	N.A.	1.6
Annual Averages								
2011	3.2	**3.6**	2.0	**2.2**	2.5	**2.8**	1.7	**1.8**
2012	2.0	1.9	1.8	1.8	1.8	1.7	1.6	1.6
2013	2.1	**2.2**	1.8	**2.0**	2.0	2.0	1.7	**1.8**

Source: Survey of Economic Forecasters
Core Inflation rates exclude energy and food

Housing – ***Housing represents such a large part of household wealth that a recovery in the economy driven by consumer spending hinges on improved housing prices. The housing recovery is hampered by a low and declining rate of new household creation, a large inventory of distressed houses selling at large discounts, stringent credit standards and high unemployment. Owning is now more affordable than renting in many markets and mortgage rates are at historic lows. Yet, housing prices continue to decline.***

The housing market is improving but the pace is very slow. The inventory of existing homes for sale has dropped from eight months at the trough of the recession to six months. A more normal level of housing inventory is four months, which will take time to achieve. Most conditions for home purchases are favorable with the unusual combination of low prices, rising rents and very low mortgage rates. The two key obstacles to a housing recovery are the oversupply of foreclosed homes that keeps prices falling and credit availability for investors converting properties to rentals. At the end of October, Barclays reported that about 440,000 homes were owned by banks with another 1.9 million homes in some stage of foreclosure. U.S. home prices were down 4.3% from one year ago in November. After stripping out foreclosures and "distressed" sales, prices were down just 0.6%. Cash buyers are driving hard bargains and pushing prices lower.

New government programs are being designed to reduce additional disclosures and keep families in homes. These programs will help the housing market, but there is a need for a mechanism to clear out the stockpile of distressed houses for sale. With the higher rental rates, there are a number of potential investors who would buy homes for rental income, but credit availability is limited. In 2008, Freddie Mac and Fannie Mae limited the number of loans guaranteed to any one investor. While Fannie Mae is moving back to ten loans per investor, many banks remain stuck on four or less. A key improvement in housing prices would occur if some form of credit expansion to housing investors takes place using collateral controls of risk.

Examples of government efforts to address the housing market problem might include the elimination of capital-gains taxes on properties bought as a longer-term investment and converted to rentals. Allowances for accelerated depreciation of these properties would also help clear the market. In general, the homeownership rate is falling and rental prices will spike if there is not a way to coordinate financing of homes by investors to help clear housing inventory and make more rentals available.

As reported in prior "Outlooks," the housing market must be repaired for a sustained recovery. But, serious programs to lower obstacles to investment purchases of housing are not likely to take place in an election year. The recovery could strengthen in 2013 if plans to address the housing inventory are forthcoming.

Global Economy - *The IMF global economic forecasts were revised downward from mid-year estimates. Fallout from the pending recession in Europe will dampen growth in other countries.*

The IMF forecasts that the global economy will expand 3.3% this year, down from 3.8% last year. Overall, the IMF sees global growth slowing but not collapsing. All economies will try to boost labor saving productivity without losing good paying jobs. The growth rate of per capita income globally has been around 2.5 percent since the beginning of the century but this rate is expected to fall below 2 percent sometime between 2017 and 2025. Unlike the past half century, the slowdown will also be accompanied by slower growth in population.

The global forecast was revised downward from September's 4% growth estimate for 2012, largely due to concerns that the recession in Europe will be deeper than expected. Financing costs of Europe's biggest economies are hitting levels not seen since the launch of the European Economic and Monetary Union. Thin financial market credit and fiscal tightening is likely to put Europe into a recession. Only the depth of the slowdown in Europe is in question.

The IMF expects advanced economies, including the U.S., Japan, the U.K. and the euro zone, to grow only 1.5% on average through 2013. The IMF also reiterated its concerns that the U.S. and Japan have not made enough progress on deficit reduction and paying down debt. Growth in emerging and developing economies is slowing as European banks are spending less overseas and exports to Europe are shrinking. The IMF forecasts that emerging economies will expand as a bloc by 5.4% this year and 5.9% next year, which is a half a percentage point lower than prior estimates. The IMF lowered China's growth forecast by nearly a percentage point to 8.2% for the year, down from a previous forecast of 9%.

Consequences of the Euro Recession for the U. S. - ***The fallout from a recession in Europe is likely to go well beyond lower U. S. exports.***

The U.S. economy is likely to suffer through significant fallout from the European recession. The U.S. Treasury Department has maintained that the major risk to the U. S. is through weak exports to Europe but the banking sector is also vulnerable to the euro zone's downturn. The delevering process that must take place in Europe could promote a credit crunch that could be felt around the world. Such a credit crunch would pull trade and investment away from emerging and developing economies. The IMF also notes potential impacts on the U. S. banking system to include direct exposures of U.S. banks to euro-area banks and the market impact of the sale of U.S. assets by European banks. A case in point is the downward pressure on pricing of commercial-backed mortgage securities and asset-backed securities in recent months due to the volume of European asset sales. European banks are trimming down portfolios of assets to raise capital in order to meet new financial regulations and prepare for a sovereign-debt price collapse. A year ago the U.S. Congressional Research Service (CRS) estimated that U.S. bank exposure to the euro-zone debt crisis was $640 billion. It also noted that the exposure could be much higher depending on the exposure of non-bank financial institutions and exposure through secondary channels. The CRS estimate didn't include U.S. bank exposure to European bank portfolios that include assets in all weak euro-zone member countries. The report also did not account for euro-zone assets held by money-market, pension and insurance funds.

Summary of Recent Market Data and Trends

- **GDP** – *The economy stumbled through 2011 and expectations for 2012 suggest another slow year ahead. The economy grew 1.7% in 2011 following 3% growth in 2010. Growth in 2012 is likely to fall short of the 3% benchmark required for real improvement in the labor market. Risks to the downside of the Fed's 2012 estimate of 2.5% are high.*

- According to advanced estimates, real seasonally adjusted GDP rose at an annual rate of 2.8% in the last quarter of 2011 following a revised 1.8% growth in the third quarter.

- About two-thirds of fourth quarter GDP growth came from a rise in inventories, which will cause a drag on GDP growth in the first quarter of 2012.

- Real final sales to domestic purchasers, which exclude trade and inventories, rose only 0.9% at an annual rate in the fourth quarter. Real final sales to domestic purchases were 2.7% in the third quarter.

- Table 1 below shows the breakdown of quarterly GDP growth for 2010 and 2011. Net exports and government were both drags on fourth quarter growth while inventory investment represented a large increase. Consumer spending and residential construction were the only other components that showed improvement.

Table 1. GDP by Quarter for 2010 and 2011

Annualized % Change	2011 Q4	2011 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010 Q2	2010 Q1
Real GDP	2.75	1.81	1.33	0.36	2.35	2.51	3.79	3.93
Consumption	1.45	1.24	0.49	1.47	2.48	1.85	2.05	1.92
Fixed Investment	0.41	1.52	1.07	0.15	0.88	0.28	2.12	0.15
Residential	0.23	0.03	0.09	**- 0.06**	0.06	**- 0.76**	0.50	**- 0.41**
Non Residential	0.18	1.49	0.98	0.20	0.82	1.04	1.62	0.56
Inventory	1.94	**- 1.35**	**- 0.28**	0.32	**- 1.79**	0.86	0.79	3.10
Net Exports	**- 0.11**	0.43	0.24	**- 0.34**	1.37	**- 0.68**	**- 1.94**	**- 0.97**
Government	**- 0.93**	**- 0.02**	**- 0.18**	**- 1.23**	**- 0.58**	0.20	0.77	**- 0.26**

Negative components to GDP growth in a given quarter are noted in red
Source: Bureau of Economic Analysis

Production and Manufacturing - *Production is picking up and capacity utilization continues to increase. Recent manufacturing data offer an upbeat view for 2012. The picture will be less rosy if the recession in Europe puts a large dent in U.S. exports.*

- U.S. factories boosted output in January by the most in seven months, according to the Institute for Supply Management's manufacturing index.
- The Commerce Department reported that construction spending rose 1.5 percent in December for the fifth consecutive monthly gain.
- Total industrial production in December was 2.9 percent above its level of a year earlier. The capacity utilization rate for total industry rose to 78.1 percent, which is 2.3 percentage points below its long-run (1972--2010) average.
- For the fourth quarter as a whole, industrial production rose at an annual rate of 3.1 percent, the 10th consecutive quarterly gain. In the manufacturing sector, output advanced 0.9 percent in December with similar gains for both durables and nondurables.
- Table 2 summarizes the production and capacity utilization data since July 2011.

Table 2. Industrial Production and Capacity Utilization

	Dec 2011	Nov 2011	Oct 2011	Sept 2011	Aug 2011	July 2011	Dec 2010 to Dec. 2011 % Change
Industrial Production Index	95.3	94.9	95.1	94.6	94.4	94.1	
Industrial Production % Change	.4	-.3	.6	.2	.2	1.1	2.9
Capacity Utilization Total Industry	78.1	77.8	78.1	77.7	77.6	77.5	1.2

Index = 100 in 2007
1972-2010 Average Capacity Utilization = 80.4
Data are Seasonally Adjusted

- Manufacturing started out the year on a positive note with new orders, production and employment all growing in January. The PMI was 54.1 percent in January following December's seasonally adjusted reading of 53.1 percent. The index has increased for 30 consecutive months. A PMI index above 50 indicates an expansion in manufacturing.

- The New Orders component of the PMI increased 2.8 percentage points in January, marking the 33rd consecutive month of growth in new orders. Prices of raw materials increased for the first time in the last four months.

Inflation - *The Federal Reserve committed to keeping interest rates low into mid-2014, suggesting a greater concern for economic growth than inflation. Additional monetary easing is expected since the recent downshift in inflation gives the Fed added flexibility. The energy index continued to display weakness in December amid falling gasoline, natural gas and electricity prices.*

- The consumer price index (CPI) was unchanged in December and has not been positive since September. A decline in the energy index over the last three months of 2011 helped keep the CPI in check. The core CPI remained tame with a .1% increase in December. Table 3 below summarizes the monthly movement in the CPI and Core CPI since May of 2011.

- The year-ago change in the CPI fell to 3% in December. The year-ago change in the Core CPI held its 2.2% increase in December, consistent with an acceptable level of inflation used by policymakers.

- Consumers are benefiting from minimal inflation. Consumer prices, as measured by the PCE deflator, were up 0.1% after falling slightly for two straight months. Excluding food and energy, prices rose 0.2%, the fastest growth since August.

- The PCE index was 2.4% above the year-ago level in total, the slowest inflation since April and up 1.8% excluding food and energy. The core increase was the fastest since October 2009.

Table 3. Monthly and Year-Ago Changes in Inflation since May 2011

	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011	Jun 2011	May 2011
Month to Month % Change								
CPI	0.0	0.0	-0.1	0.3	0.4	0.5	-0.2	0.2
Core CPI	0.1	0.2	0.1	0.1	0.2	0.2	0.3	0.3
PCE	0.1	0.0	0.0	0.2	0.3	0.4	-0.1	0.2
Core PCE	0.2	0.1	0.1	0.0	0.2	0.2	0.2	0.3
Year Ago % Change								
CPI	3.0	3.4	3.6	3.9	3.8	3.6	3.4	3.4
Core CPI	2.2	2.2	2.1	2.0	2.0	1.8	1.6	1.5
PCE	2.4	2.6	2.7	2.9	2.9	2.8	2.6	2.6
Core PCE	1.8	1.7	1.7	1.6	1.7	1.6	1.4	1.3

Source: Bureau of Labor Statistics

- Subdued investor sentiment and partial easing of supply constraints in commodity markets are softening headline inflation. The energy index continued to display widespread weakness in December amid sharply falling gasoline, natural gas and electricity prices. The food index ticked up from the previous month, but remains modest relative to the inflation through most of 2011.

- Producer prices displayed broad-based weakness in December, supporting the outlook for continued moderation in overall inflationary pressures in the economy for the coming months.

- Producer prices fell 0.1% in December, the second drop in three months. The small drop in the overall finished good index was due to a decline in the finished energy goods index and a reversal in the finished foods index. Prices in the earlier stages of production declined, signaling further rounds of weakening producer and consumer price inflation. Monthly PPI data are provided in Table 4.

Table 4. Monthly Changes in the Producer Price Index (PPI) since May 2011

PPI % Change	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011	Jun 2011	May 2011
Finished Goods - monthly	-0.1	0.3	-0.3	0.7	0.2	0.3	-0.3	0.1
Finished Goods – Year Ago	4.8	5.9	6.1	7.0	6.6	7.1	6.8	6.8

Source: Bureau of Labor Statistics

- The Personal Consumption Expenditure (PCE) price index for the fourth quarter increased 0.9% following a much higher annualized rate of 2.1% in the third quarter. The core PCE inflation rate moderated even more dramatically, from 2.3% to 0.7%. Inflation concerns remain low allowing the Federal Reserve to continue a loose monetary policy.

Unemployment - *The improving trend in employment growth continued into January. Payrolls increased by a whopping 243 thousand in January based on the preliminary data release. The increase in payroll employment was much better than expected and the unemployment rate declined to 8.3%, a new low for the recovery. Employment conditions are somewhat healthier but the labor market still has a long way to go to reach full employment. Most economists expect the unemployment rate to go up later in 2012.*

- The U.S. job market strengthened at the start of the year as employers added an unexpected large number of new jobs and the unemployment rate in January dropped for the fifth straight month to 8.3%--the lowest in nearly three years.

- The Labor Department announced that employers added 243,000 net new jobs in January – about 100,000 more than what analysts were forecasting. Job gains were broad-based.

- Revised data showed that employers added 157,000 jobs in November, compared to 100,000 initially estimated. Job growth in December was 203,000. For all the encouraging news, the BLS report had 12.8 million people remained unemployed – 43% of them for more than six months. The report also showed that another 8.2 million part-time workers couldn't find full-time employment. Table 5 shows the monthly unemployment and labor data since July of 2011.

Table 5. Unemployment and Labor Force Participation

	Jan 2011	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011
Unemployment Rate (%)	8.3	8.5	8.7	8.9	9.0	9.1	9.1
Labor Force Participation Rate (%)		64.0	64.0	64.1	64.1	64.1	64.0
Change in Non-farm payrolls (000s)	243	203	157	112	210	104	127

Seasonally Adjusted Data
Source: Bureau of Labor Statistics (BLS)

- Total payrolls now stand about 5.6 million less than at the start of the recession in late 2007.

- The size of the U.S. workforce has remained nearly constant for four years due to slower growth in the working-age population along with a declining labor force participation rate (2 percentage point drop in the past four years).

- Average hourly earnings increased 0.2% and the workweek increased slightly to 34.4 hours.

- Gains in nonfarm payrolls averaged 137,000 per month in the fourth quarter, which is down from the 147,000 average increase in the third quarter but up from the 131,000 per month gain for the first half of the year. For all of 2011, employment growth averaged 137,000 per month, nearly double the 78,000 average monthly rise in 2010.

- The average workweek for all employees reversed November's decline with a 0.1 increase to 34.4 in December.

- Average hourly earnings for all employees rebounded 0.2% in December, pushing up the year-ago increase to 2.1% from 1.9%.

- Jobless claims rose by 21,000 to 377,000 for the week ending January 21. The prior week's data were revised from 352,000 to 356,000. Data for jobless claims appears in Table 6.

Table 6. Initial and Continuing Jobless Claims

	21 Jan 2012	14 Jan 2012	07 Jan 2012	31 Dec 2011	24 Dec 2011	17 Dec 2011	10 Dec 2011
Initial Claims (thousands)	377	356	402	375	387	366	368
4 week MA	378	380	383	374	377	381	388
Continuing Claims (millions)	NA	3.47	3.65	3.61	3.62	3.57	3.55
4 week MA	NA	3.57	3.58	3.61	3.61	3.60	3.64

Source: Employment and Training Administration

- The four-week moving average, which evens out seasonal noise affecting weekly readings, edged lower to 377,500 from 380,000 in January.

- Continuing claims for the week ending January 14 increased to 3.554 million from 3.466 million. The four-week moving average was 3.569 million. Claims, while volatile, are near levels found in healthy labor markets, suggesting that low hiring rather than jobless claims is the root problem.

- Employer costs (see Table 7) rose by 0.4% in the fourth quarter of 2011, a slight uptick from the prior quarter's 0.3% expansion. The wages and salaries component grew 0.4%, while the benefits component gained 0.6%. Labor costs are not likely to increase much until employment data turn up significantly.

- On a year-ago basis, total compensation growth held at 2% in the fourth quarter of 2011. Compared with one year ago, benefits were up 3.2%.

Table 7. Employment Costs Index

	2011 Q4	2011 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010Q 2
Quarterly % Change							
Total compensation	0.4	0.3	0.7	0.6	0.4	0.4	0.4
Wages	0.4	0.3	0.4	0.4	0.4	0.3	0.4
Benefits	0.6	0.1	1.3	1.1	0.5	0.7	0.6
% Change Year Ago							
Total compensation	2.0	2.0	2.2	2.0	2.0	2.0	1.8
Wages	1.5	1.5	1.5	1.5	1.6	1.5	1.6
Benefits	3.2	3.1	3.7	3.0	2.9	2.8	2.5

Source: Bureau of labor Statistics

- ISM's Employment Index registered 54.3 percent in January, which is 0.5 percent lower than the seasonally adjusted 54.8 percent reported in December. This is the 28th consecutive month of growth in the Employment Index. An Employment Index above 50.5 percent, over time, is generally consistent with an increase in the Bureau of Labor Statistics (BLS) data on manufacturing employment.

Personal Income and Saving - *Consumers do not have the resources to lead the recovery on a consistent basis. It is more likely that consumers will maintain spending growth near the pace of overall economic expansion. Positive factors that will help maintain spending include pent-up demand, improved confidence measures, lower debt burdens and improving access to credit. Nevertheless, confidence levels remain low and near recession levels while jobs and wages are not growing very fast.*

- Consumers finally boosted their saving in December after months of declining savings rates. Saving hovered near 5% the first half of the year while falling to below 4% in the second half.

- Nominal consumer spending declined slightly in December, the first time it has not increased since June. Real spending fell 0.1%. Personal income rose 0.5%. For the fourth quarter, spending rose only 0.5%.

- Tax payments continued to rise rapidly, limiting the increase in disposable income to 0.4%. The saving rate jumped to 4% from 3.5%. Table 8 provides monthly data on income, consumption and savings.

Table 8. Personal Income, Consumption and Savings Rate since May 2011

	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011	Jun 2011	May 2011
% change by Month								
Personal Income	0.5	0.1	0.4	0.2	-0.1	0.1	0.1	0.1
Consumption	0.0	0.1	0.1	0.7	0.1	0.8	-0.2	0.2
% Change Year Ago								
Personal Income	3.8	3.8	3.9	4.1	4.0	4.6	4.9	5.0
Consumption	3.9	4.3	4.6	5.1	4.6	5.1	4.7	4.9
Savings	4.0	3.5	3.6	3.5	4.1	4.3	5.0	4.7

Source: Bureau of Economic Analysis

Sentiment and Confidence in the Economy – *Overall, sentiment remains very low from a historical perspective, but it is improving. The current level of confidence is more compatible with an economy in a recession rather than a recovery. Despite recent declines in unemployment, wage income is growing slowly and disposable income growth is even weaker. Tax payments have increased rapidly and transfer income is falling with no other offsets. Not all sentiment measures moved in the same direction over the past months. The University of Michigan index improved while the Conference board's Index of Consumer Confidence declined. The lack of consistency in confidence measures reflects the overall uncertainty in the economy.*

- The University of Michigan consumer sentiment index rose more than expected in January of 2012, with improvement in both views of current conditions and expectations. Confidence continues to improve since August. The index was 75 in January and 69.9 in December. The index has now risen in five consecutive months, reaching its highest level since last February. Consumers are feeling less pessimistic as the labor market slowly improves and equity prices rise higher.

- Table 9 provides a monthly summary of the University of Michigan sentiment survey. Expectations for inflation were slightly stronger in the near term, but remained stable for the long run. The one-year expectation is up from 3.1% to 3.3%, while the five-year expectation settled at an unchanged 2.7%.

Table 9. University of Michigan Consumer Sentiment

	Jan 2012	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011	Jun 2011
Overall Index	75.0	69.9	64.1	60.9	59.4	55.7	63.7	71.5
Change in the Index	5.1	5.8	3.2	1.5	3.7	**-8.0**	**-7.8**	**-2.8**
Inflation Expectations 1 Yr.	3.3	3.1	3.2	3.2	3.3	3.5	3.4	3.8
Inflation Expectations 5 Yr..	2.7	2.7	2.7	2.7	2.9	2.9	2.9	3.0

Source: University of Michigan

- The Conference Board Index of Consumer Confidence fell in January, declining to 61.1 from 64.8 (revised up from 64.5). The present situation component led the decline, falling from 46.5 (previously 46.7) to 38.4. The expectations component dropped slightly from 77 (previously 76.4) to 76.2. The decline went against expectations of increasing confidence and is a sign of consumers' uncertain views of the economic recovery.

Table 10. Conference Board's Consumer Confidence Index

	Jan 2012	Dec 2011	Nov 2011	Oct 2011	Sep 2011	Aug 2011	Jul 2011	Jun 2011
Overall Index	61.1	64.8	55.2	40.9	46.4	45.2	59.2	57.6
Present conditions	38.4	46.5	38.3	27.1	33.3	34.3	35.7	36.6
Expectations	76.2	77.0	66.4	50.0	55.1	52.4	74.9	71.6
Buying Plans –Auto	9.6	10.2	12.2	11.7	11.1	13.0	11.9	11.5
Buying Plans- Home	4.2	5.4	4.9	4.4	4.7	4.0	4.9	4.3
Buying Plans – Appliance	47.0	47.6	49.4	47.2	40.8	49.4	47.7	49.3

Source: Conference Board

- Consumer confidence fell 3.7 points in January, according to the Conference Board. This was the first decline in three months, following strong gains in the prior two months.

- The decrease was led by an 8.1-point drop in the present conditions index. The expectations index inched down 0.8 points.

- Assessments of current labor market conditions deteriorated slightly. The share of consumers finding jobs hard to get, at 43.5%, rose to a three-month high, while the share that found jobs plentiful pared gains from the previous month, falling back down to 6.1%.

- There was a noticeable decline in the expectations for future income gains. The share of consumers expecting higher incomes in six months dropped from 16.3% to 13.8%. The portion of consumers who feel that business conditions will be better was lower, while the portion of consumers who feel they will be worse increased from 13.4% to 15.1%.

Leading Indicators - *The Conference Board index of leading indicators increased by 0.4% in December, marking the third consecutive monthly gain. The results are consistent with moderate growth in 2012.*

- The Conference Board index of leading indicators (see Table 11), rose 0.4% in December. The rising interest rate spread contributed most to this month's gain, but improving jobless claims data were the second largest contributor to the positive results. The average workweek component was also higher.

- The gains were broad-based, as eight of the survey's 10 components increased. The ISM new orders component was up for the second month in a row, while stock prices posted the third consecutive monthly gain.

Table 11. Conference Board's Index of Leading Indicators

	Dec 11 2011	Nov 11 2011	Oct 11 2011	Sep 11 2011	Aug 11 2011	Jul 11 2011	Jun 11 2011
Leading Index	94.3	93.9	93.7	93.1	93.7	94.4	94.2
% Change	0.4	0.2	0.6	-0.6	-0.7	0.2	0.0
% Change-3 Month MA	0.4	0.1	-0.2	-0.4	-0.2	0.2	0.2

Note: 2004 Index = 100
Source: Conference Board

Housing - *Despite continued low interest rates and better real GDP growth in the fourth quarter, home prices continue to fall. The market must work through an inventory of distressed sales to see stability in housing prices.*

- Total existing-home sales, including single-family and condo, jumped 13.9 percent to a seasonally adjusted annual rate of 6.03 million in the fourth quarter from 5.29 million in the third quarter. Existing home sales are 27.2 percent above the 4.74 million-unit level in the fourth quarter of 2008. Distressed property accounted for 32 percent of fourth quarter transactions, down from 37 percent a year earlier.

- The median existing single-family price was $172,900, which is 4.1 percent below the fourth quarter of 2008. While prices fell, it is the smallest price decline in over two years.

- Approximately 86.1 percent of housing units in the United States were occupied in the fourth quarter of 2011and 13.9 percent were vacant. Owner-occupied housing units made up 56.9 percent of total housing units, while renter-occupied units made up 29.3 percent of the inventory in the fourth quarter 2011.

- Vacant year-round units comprised 10.5 percent of total housing units, while 3.4 percent were for seasonal use.

- The homeownership rate of 66.0 percent was 0.5 percentage points lower than the fourth quarter 2010 rate (66.5 percent) and 0.3 percentage points lower than the rate last quarter (66.3 percent).

- The S&P/Case-Shiller Home Price Indices, the leading measure of U.S. home prices, showed declines of 1.3% for both the 10- and 20-City Composites in November over October. For a second consecutive month, 19 of the 20 cities covered by the indices also saw home prices decrease. The 10- and 20-City Composites posted annual returns of -

3.6% and -3.7% versus November 2010, respectively. These are worse than the -3.2% and -3.4% respective rates reported for October.

- The months of supply of housing inventory is now at about 6 months from a high of just over 12 months. The average number of months of inventory remained at about 4 months prior to 2006.

Global Economy - *The outlook for the global economy in 2012 isn't pretty. Recession in Europe, anemic growth in the United States, a sharp slowdown in China and slowing in most emerging-market economies all weigh on global growth potential. Asian economies are exposed to China. Latin America is exposed to lower commodity prices (as both China and the advanced economies slow). Central and Eastern Europe are exposed to the Eurozone. If these threats were not enough, turmoil in the Middle East is causing serious economic risks – both there and elsewhere – as geopolitical risk remains high.*

- At this point, a Eurozone recession is almost certain. While its depth and length cannot be predicted, a continued credit crunch, sovereign-debt problems, lack of competitiveness and fiscal austerity imply a serious downturn.

- The US faces considerable downside risks from the Eurozone crisis. It must also contend with significant fiscal drag, ongoing deleveraging in the household sector (amid weak job creation, stagnant incomes, and persistent downward pressure on real estate and financial wealth) and political gridlock.

- In the U.K., Eurozone exposure undermines growth while expansionary policy is underway.

- In Japan, the post-earthquake recovery may stall unless structural reforms take place.

- Flaws in China's growth model are becoming obvious. Falling property prices will have a negative ripple effect on developers, investment and government revenue. The construction boom is ending, just as net exports have become a drag on growth due to weakening demand in US and Eurozone.

- On the policy side, the US, Europe and Japan have been postponing the serious economic, fiscal and financial reforms that are needed to restore sustainable and balanced growth.

- The Conference Board predicts global growth of 3.5 percent in 2012 and 3.6 percent from 2013-2016.

- The Conference Board expects growth in advanced economies to slow from an already meager 1.6 percent in 2011 to 1.3 percent in 2012. For 2013-2016, the outlook suggests

that advanced economies will get back to the pre-recession growth trend of about 2 percent.

- For emerging economies in 2012, the Conference Board expects growth to slow by 0.7 percent on average, going from 6.3 percent growth in 2011 to 5.6 percent in 2012.

Global Outlook for GDP Growth 2012-2025

Source: Conference Board
EU-15 refers to states that joined the European Union before 2004.