First Trust
Monday Morning OUTLOOK
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Was The 2011 Economy A Miracle?

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Senior Economist*
Strider Elass – *Economic Analyst*
Andrew Hull – *Economic Analyst*

The year (2011) started on a high note, and apparently, will end on one, too. What happened in the middle was frantic, noisy and bothersome.

A year ago, in late 2010, the bears had seemingly gone to sleep. The Dow Jones Industrial Average (DJIA) finished 2010 at 11,576, up 15.6% in the final four months of the year. Real GDP grew 3.1% in 2010, its fastest expansion since 2005. The unemployment rate was still high (9.4%), but private sector job growth had been positive for 10 consecutive months.

The stock market continued to roll in early 2011, with the DJIA hitting 12,810 on April 29th. Our forecast of 14,500 for the end of the year looked reachable.

And then, the wheels sort of fell off, or at least it looked like they had. Real GDP growth slowed sharply, the unemployment rate ticked higher and the stock market had a major (16%) correction. For August, both retail sales and non-farm payrolls were reported as big fat zeros.

Massive tornadoes tore up Tuscaloosa, AL and Joplin, MO. A tsunami hit Japan and a major nuclear event unfolded. Washington, DC went to war over the debt ceiling. Standard & Poor's downgraded US Treasury debt, while Europe started to fall apart financially. The Super Committee failed to reach any kind of agreement on deficit reduction. MF Global filed for bankruptcy.

The bears woke up, turned the amplifier volume up all the way to 11, and started screaming about an imminent recession. They had a lot to scream about and they had a very receptive audience.

In August, after the weak data of the summer, Nouriel Roubini said, "The macro data…will come out worse and worse, the market will start to correct again. We're going to a recession, we are at stall speed and we are running out of policy bullets." In September, Lakshman Achuthan, co-founder of ECRI said the US is, "indeed tipping into a new recession. And there's nothing that policy makers can do to head it off." He has reiterated this call in recent months.

For some reason, bearish calls (about recession or depression) get a massive amount of coverage in the press – headlines, breaking news banners, and continued references in any story about economic data or markets for weeks or months after the call is made.

Instead of a 2011 recession, the economy slowed early, but then picked up speed as the year progressed. Real GDP grew just 0.3% at an annual rate in the first quarter, accelerated to 1.3% annualized growth in Q2, 1.8% in Q3, and the consensus puts Q4 real GDP growth at 3.5% to 4.0%. And remember those zeros in August? Revisions now show positive retail sales and employment growth in August. Not only did the economy avoid recession, but we remain confident that economic growth in 2012 will accelerate.

We look at the economy like a scale, with good things on one side and bad things on the other. Our models suggest that the good things outweigh the bad. This was true in 2009, 2010, 2011 and now 2012.

On the good (or growth) side, we place new technology, the Fed and a slightly better fiscal outlook.

The US is experiencing a wave of new technologies – the cloud, tablets, smart-phones among the most important. New oil and natural gas drilling techniques are also part of the mix. New technologies are increasing productivity and output despite the Super-Committee, S&P downgrades and European financial problems. The Fed is accommodative and federal spending is declining as a share of GDP. Combined, these developments all will boost growth.

On the bad side, government spending is too high, regulation is burdensome, and the Fed is accommodative.

Government spending may be falling as a share of GDP, but it is still very high. This limits job creation and holds back real GDP growth from its true potential. Excessive regulation does the same thing. And while an easy Fed boosts growth, it also creates inflation, which will become more of a problem in the years ahead.

Netting all this out, the scale is still tilted toward growth. New US technologies and the productivity that they create are so powerful and positive that they are overwhelming the drag from bad government policies. Compared to forecasts of recession, it's a miracle. Look for another one in 2012.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-27 / 9:00 am	Consumer Confidence - Dec	58.6	**60.7**	64.5	56.0
12-29 / 7:30 am	Initial Claims - Dec 23	374K	**370K**		364K
12-29 / 8:45 am	Chicago PMI - Dec	61.0	**63.1**		62.6