First Trust
Monday Morning OUTLOOK
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Outlook for 2013

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For quite some time, we have been calling the current US recovery the Plow Horse Economy. It's not even close to a record-setting thoroughbred, like the mid-1980s or late 1990s, when real GDP growth averaged nearly 4% per year. Far from it. But it's not going to keel over and die with a recession either.

Real GDP grew 2% in 2011 and, despite a farm drought and Super Storm Sandy, is going to clock in at right about the same pace for 2012. (The first report on Q4 GDP comes out on January 30.)

For 2013, we expect a little faster real GDP growth of 2.75%. Don't get too excited, though. It's not as if this is some positive reaction to tax hikes. Rather, it's driven by replenishment of farm inventories after the drought as well as some rebuilding from Sandy, two factors that are temporary.

Having said this, there are some signs that the underlying trend for growth has improved. Monetary policy is loose and there is a natural, free-market recovery in housing underway. Nominal GDP is up at a 4.2% annual rate the past two years. As the economy continues to recover, a target federal funds rate near zero becomes looser over time. As a result, growth should pick up.

Meanwhile, housing starts are up 22% from a year ago but still need to climb 65-70% in the next few years just to get to a pace of construction where housing inventories stop falling. More home building should translate into faster GDP growth and an acceleration in consumer spending.

On the inflation front, CPI inflation fell from 3% in 2011 to about 1.8% in 2012 (data for December prices will be released January 16). With monetary policy very loose, we expect a rebound back to 3% in 2013. But the composition of the inflation is likely to be different than 2011, with less of an increase in energy prices and more of an increase in housing costs and other items, like health care and education.

For interest rates, the short side of the yield curve looks like an easy call. The Federal Reserve says it will keep short-term rates where they are until the unemployment rate hits 6.5%. That probably won't happen in 2013 – we expect the jobless rate to end the year at about 7% – so the Fed will stand pat on rates.

However, we expect enough of a drop in the jobless rate to put multiple rate hikes on the table for 2014. In addition, by year-end, the Fed will be talking about how to start reversing the balance sheet expansion it recently launched.

On the long end of the curve, we expect an increase in the 10-year yield to 2.85% by year-end 2013. With nominal GDP growing at a 4%+ pace, economic fundamentals suggest long-term rates should already be higher. By pledging to hold down rates, the Fed is artificially holding down the whole yield curve. But, as the jobless rate moves down this year, investors will reassess the timing of rate hikes, eroding the Fed's ability to keep a lid on long-term rates.

In making our forecast, we assume pretty much more of the same from the global political class. In Europe, they will continue to muddle through; in Washington, some minor gestures toward getting a handle on our long-term fiscal problems, but without any major reforms.

We see this as a glass half full. If the two sides ever reach a "grand bargain" that really is a grand bargain, we would be happy to say we were not bullish enough. Nonetheless, our outlook for 2013 remains on the optimistic side, especially when compared to the conventional wisdom, which has expected a double-dip recession for the past 3 ½ years. But, more Plow Horse growth is the most likely path for the next year.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-8 / 2:00 pm	Consumer Credit - Nov	$10.8 Bil	**$15.0 Bil**		$14.2 Bil
1-10 / 7:30 am	Initial Claims - Jan 5	365K	**365K**		372K
7:30 am	International Trade Balance - Nov	-$41.3 Bil	**-$40.1 Bil**		-$42.2 Bil
1-11 / 7:30 am	Import Prices - Dec	+0.0%	**+0.3%**		-0.9%
7:30 am	Export Prices - Dec	-0.2%	**-0.1%**		-0.7%