RAYMOND JAMES

Economic Research

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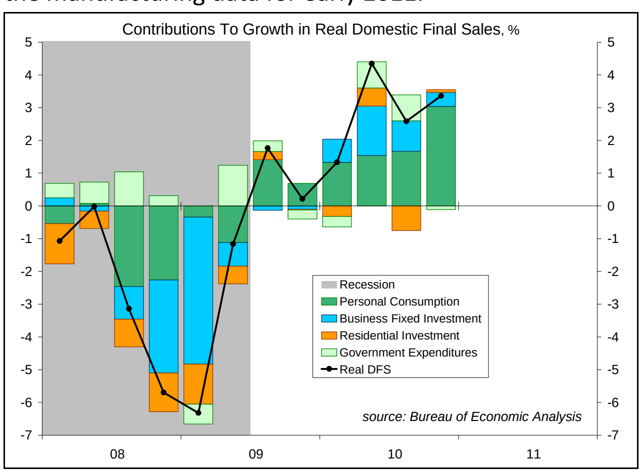
Monthly Economic Outlook

Upgrading The Near-Term Outlook

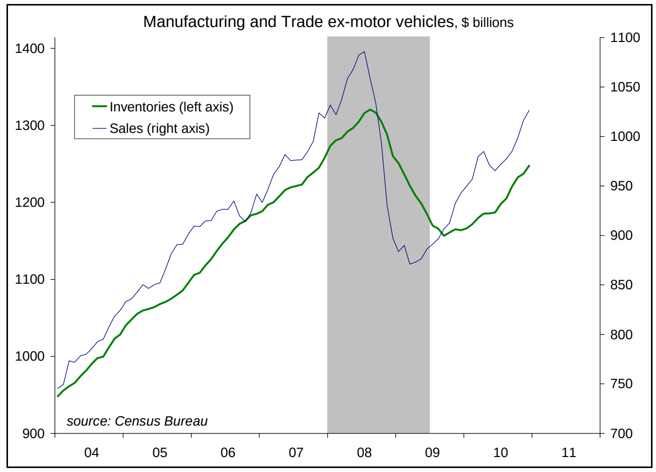
- *The economy appears to have entered 2011 with an increased amount of momentum. There are still a few headwinds, but the recovery is picking up a bit of steam.*
- *Job destruction has continued to trend at a low level. New hiring should improve in the spring.*
- *The Federal Reserve is set to complete its $600 billion asset purchase program by the end of June, but should continue to reinvest principal payments from its mortgage portfolio into long-term Treasury securities. An increase in short-term interest rates is not expected until 2012.*

Real GDP rose at a 3.2% annual rate in the advance estimate for 4Q10, with unusually large swings in the change in inventories and in net exports. It appears that many businesses may have bought into double dip worries or held production back due to uncertainty about tax policy (which wasn't resolved until mid-December). A sharply lower pace of inventory accumulation subtracted 3.7 percentage points from the headline growth figure. Net exports (a smaller trade deficit) added 3.4 percentage points to growth. Exports continued to advance, but imports fell (note that many firms have held an increasing portion of inventories abroad, so lower imports may reflect the lean inventory story). Lean inventories typically lead to a pickup in production, which seems to be reflected in much of the manufacturing data for early 2011.

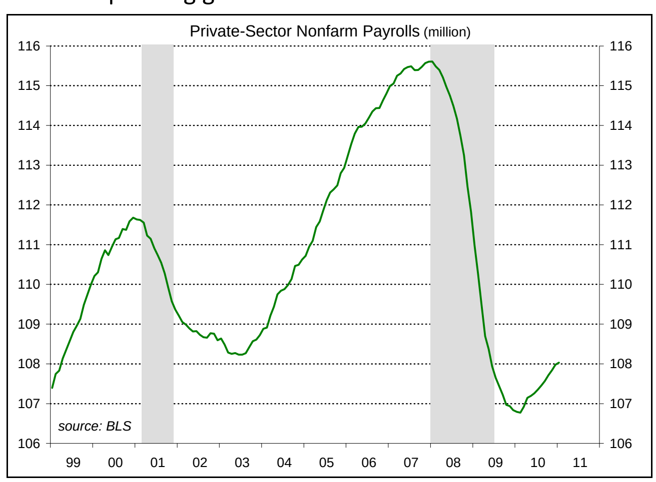


Domestic Final Sales (GDP less net exports and the change in inventories), the preferred measure of underlying domestic demand, rose at a 3.4% annual rate in 4Q10, up 2.9% from a year earlier. Inflation-adjusted consumer spending rose at a 4.4% annual rate, fueled partly by a drop in the savings rate (which fell from 5.9% to 5.4%). The increase in spending was a surprise relative to earlier expectations. Business fixed investment also rose at a 4.4% pace, somewhat slower than in recent quarters, likely reflecting some degree of caution about whether the Bush tax cuts would be extended.

The 4Q10 GDP figures will be revised on February 25 (and again on March 25), but the story is unlikely to change much. Following a strong build up in inventories in the third quarter, some correction was anticipated. However, it wasn't expected to come all in one quarter. It now looks like a small inventory rebuild will add to GDP growth in the first half of the year.

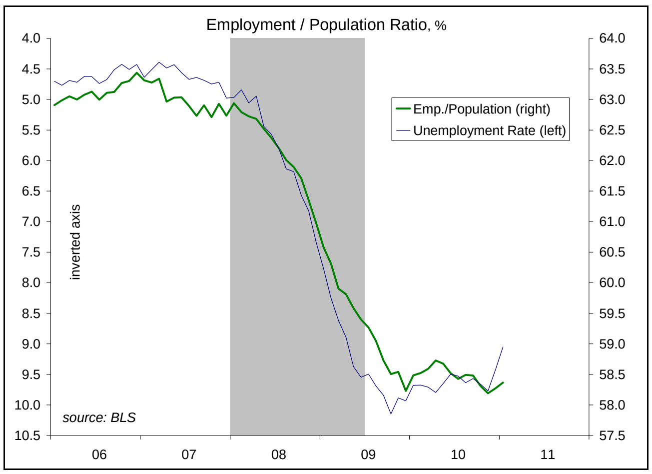


December's tax cut agreement included a 2% reduction in the employee-paid portion of payroll taxes. Some of this will be offset by higher gasoline prices and the expiration of the Making Work Pay tax credit (which was part of the federal fiscal stimulus package). However, we should see a significant increase in disposable income in 1Q11, which will help support consumer spending growth.



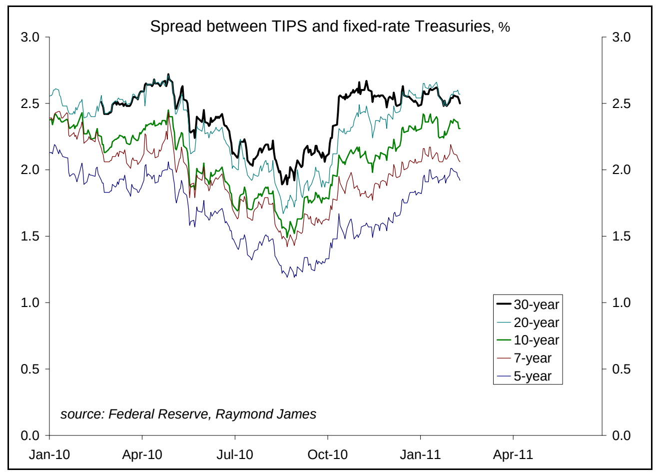
Private-sector payrolls rose by a disappointing 50,000 in the initial estimate for January. One should not put too much emphasis on any one month's worth of data. Poor weather was likely a factor in January. However, the labor market remains a major concern. It will still take a number of years to regain the jobs that were lost during the downturn. In addition, about 1.3 million workers can be expected to be added to the workforce each year (due to population growth).

The good news is that job destruction remains low. Announced corporate layoff intentions for 2010 were the lowest since 1997 and the January figure was the lowest since at least the early 1990s. The problem in the labor market is a lack of job creation. Corporate profits have continued to improve, helping to fuel business fixed investment, but higher profits do not lead to new hiring. In fact, one of the main reasons that profits are up is that firms have held the line on costs and labor is typically the largest expense for most businesses. Normally, we look to small firms to account for most of the job creation during an economic expansion. Small firms are still facing tight credit, although terms and standards for bank loans to business have begun to ease. Still, firms large and small are unlikely to add to their workforces until they see a sustained increase in demand for the goods and services they produce.



The unemployment rate fell to 9.0% in January (vs. 9.4% in December and 9.8% in November), but the figure appears to be misleading. The employment-to-population ratio, a better measure of slack in the labor market, was little changed in January and has been roughly flat over the last year.

For the most part, the job picture is a chicken-and-egg sort of question. Better economic growth will lead to more jobs, and more jobs will generate more economic growth. There are still a few headwinds in the near term (housing, strains in state and local governments), but there is a fair amount of momentum building in consumer spending and production. One concern is the recent backup in long-term interest rates (still relatively low by historical standards, but off their lows). Bond yields normally rise in an economic recovery. However, they shouldn't rise so much that they threaten the recovery. Higher mortgage rates aren't going to help the housing sector to recover. Strong job growth would help fuel home sales and relieve much of the pressure in state and local government budgets. The economic data are likely to be a bit mixed over the near term, but what happens in the spring will be key. We can expect to see a pickup in new hiring as we roll into March.



Many investors are worried about higher commodity prices. However, judging by the spreads between inflation-adjusted and fixed-rate Treasuries, inflation expectations are about where they were a year ago and holding steady.

	1Q10	2Q10	3Q10	4Q10	**1Q11**	**2Q11**	**3Q11**	**4Q11**	**1Q12**	**2Q12**	2010	**2011**	**2012**
GDP (↓ *contributions*)	3.7	1.7	2.6	3.2	**3.7**	**3.7**	**3.7**	**3.5**	**2.8**	**3.2**	2.9	**3.3**	**3.4**
consumer durables	*0.6*	*0.5*	*0.5*	*1.5*	***0.6***	***0.4***	***0.4***	***0.4***	***0.2***	***0.3***	*0.5*	***0.7***	***0.3***
nondurables & services	*0.7*	*1.1*	*1.1*	*1.6*	***1.9***	***1.7***	***1.8***	***1.7***	***1.5***	***1.6***	*0.7*	***1.6***	***1.7***
bus. fixed investment	*0.7*	*1.5*	*0.9*	*0.4*	***0.7***	***0.9***	***0.9***	***0.8***	***0.8***	***0.9***	*0.5*	***0.8***	***0.9***
residential investment	*-0.3*	*0.6*	*-0.8*	*0.1*	***0.2***	***0.3***	***0.4***	***0.3***	***0.1***	***0.2***	*-0.1*	***0.1***	***0.3***
government	*-0.3*	*0.8*	*0.8*	*-0.1*	***-0.2***	***-0.1***	***0.1***	***0.2***	***0.2***	***0.2***	*0.2*	***0.1***	***0.1***
Domestic Final Sales	1.3	4.3	2.6	3.4	**3.3**	**3.1**	**3.6**	**3.5**	**2.8**	**3.3**	1.9	**3.3**	**3.3**
exports	*1.3*	*1.1*	*0.8*	*1.0*	***0.7***	***0.7***	***0.7***	***0.7***	***0.7***	***0.7***	*1.3*	***0.8***	***0.7***
imports	*-1.6*	*-4.6*	*-2.5*	*2.4*	***-1.2***	***-0.6***	***-0.7***	***-0.7***	***-0.8***	***-0.8***	*-1.9*	***-0.7***	***-0.7***
Final Sales	1.1	0.9	0.9	7.1	**2.8**	**3.3**	**3.6**	**3.5**	**2.8**	**3.2**	2.9	**3.4**	**3.3**
ch. in bus. inventories	*2.6*	*0.8*	*1.6*	*-3.7*	***0.9***	***0.4***	***0.1***	***0.0***	***0.0***	***0.0***	*1.4*	***-0.1***	***0.1***
Unemployment, %	9.7	9.6	9.6	9.6	**9.1**	**8.9**	**8.7**	**8.6**	**8.5**	**8.3**	9.6	**8.8**	**8.3**
NF Payrolls, monthly, th.	39	181	-46	128	**135**	**185**	**180**	**175**	**170**	**190**	76	**169**	**191**
Cons. Price Index (3 mo)	0.9	-1.5	2.7	3.5	**2.5**	**1.5**	**1.6**	**1.7**	**1.7**	**1.8**	1.5	**1.8**	**1.8**
excl. food & energy	-0.2	1.3	0.7	0.7	**1.3**	**1.0**	**1.1**	**1.3**	**1.4**	**1.5**	0.8	**1.2**	**1.6**
PCE Price Index (q/q)	2.1	0.0	0.8	1.8	**2.6**	**1.5**	**1.6**	**1.6**	**1.6**	**1.7**	1.7	**1.7**	**1.6**
excl. food & energy	1.2	1.0	0.5	0.4	**1.0**	**1.1**	**1.2**	**1.3**	**1.5**	**1.5**	1.3	**0.9**	**1.4**
Fed Funds Rate, %	0.13	0.19	0.19	0.19	**0.20**	**0.24**	**0.25**	**0.25**	**0.38**	**0.82**	0.18	**0.23**	**1.01**
3-month T-Bill, (bond-eq.)	0.1	0.1	0.2	0.1	**0.2**	**0.2**	**0.2**	**0.3**	**0.5**	**1.0**	0.1	**0.2**	**1.1**
2-year Treasury Note	0.9	0.9	0.5	0.5	**0.7**	**1.2**	**1.6**	**2.0**	**2.1**	**2.2**	0.7	**1.3**	**2.3**
10-year Treasury Note	3.7	3.5	2.8	2.9	**3.5**	**3.7**	**3.8**	**3.9**	**4.0**	**4.1**	3.2	**3.7**	**4.1**

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