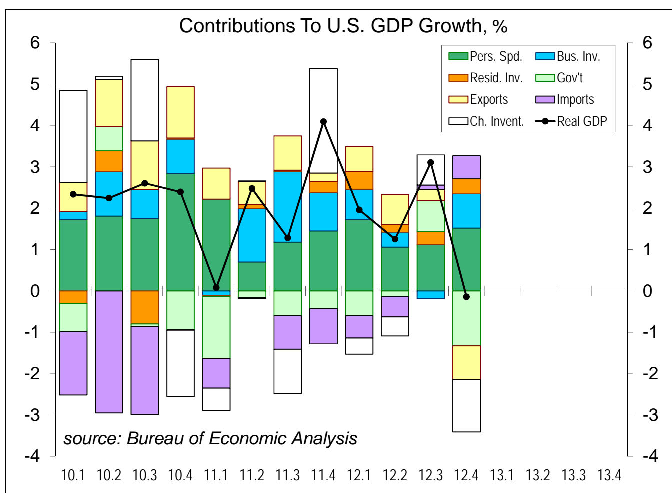
Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com **February 8, 2013**

Monthly Economic Outlook

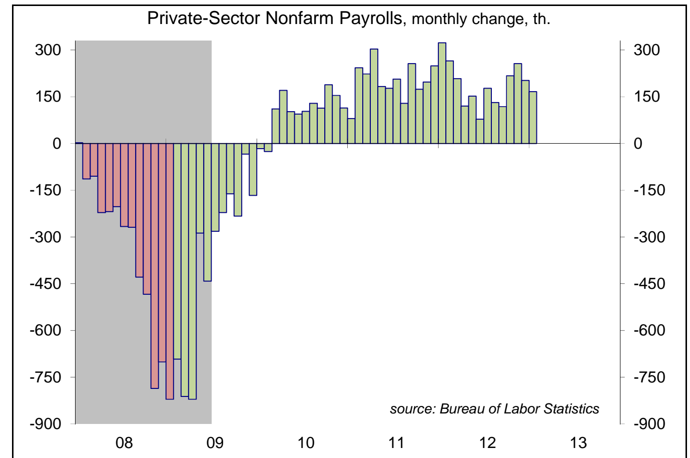
A Mixed End to 2012, Further Budget Issues Ahead

- *Real GDP ended 2012 on a weak note, reflecting a drop in defense spending and a slower rate of inventory accumulation. Job growth remained relatively strong into early 2013.*
- *The rise in payroll taxes should dampen consumer spending growth in the first half of this year, but economic growth is expected to pick up in the remainder of the year.*
- *Monetary policy is likely to remain very accommodative. Fiscal policy is more uncertainty. Large spending cuts, delayed to March 1, may be postponed further.*

Real GDP growth fell at a 0.1% annual rate in the advance estimate for 4Q12. Consumer spending rose at a 2.2% pace (also up 2.2% from a year ago). Business fixed investment rose at an 8.4% pace, vs. -1.8% in 3Q12, suggesting little concern about the fiscal cliff. Following an unexpected acceleration in 3Q12, business inventories rose at a slower pace in 4Q12, subtracting 1.3 percentage points from overall GDP growth. Defense spending fell at a 22.2% annual rate, following a 12.9% increase in 3Q12 – the underlying trend was expected to be lower (reflecting an unwinding of military effort), but these figures are uneven from quarter to quarter. GDP data will be revised, but the story is unlikely to change much. Fundamental growth was moderate, while the headline figure was restrained by temporary factors. These data tell us little about 2013.



Job growth remained strong into 2013. Nonfarm payrolls averaged a 201,000 monthly gain in 4Q12. Benchmark revisions lifted the estimate of job growth for the last two years (+181,000 per month in 2012, +175,000 in 2011). Payrolls rose by 157,000 in January, but figures for the first month of the year are unreliable (unadjusted payrolls fell by 2.8 million). The bigger test for the labor market will be the pace of new hiring from February to June. Job destruction remains low.



The pace of growth in nonfarm payrolls would be satisfactory if we were at full employment. The pace of job growth is a bit more than would be consistent with the growth in the working-age population. However, we still have high a high level of unemployment (and underemployment). The unemployment rate held roughly steady at 7.9% in January, but the employment/population ratio has trended flat over the last two years. We aren't making up much of the ground that was lost in the labor market during the downturn.

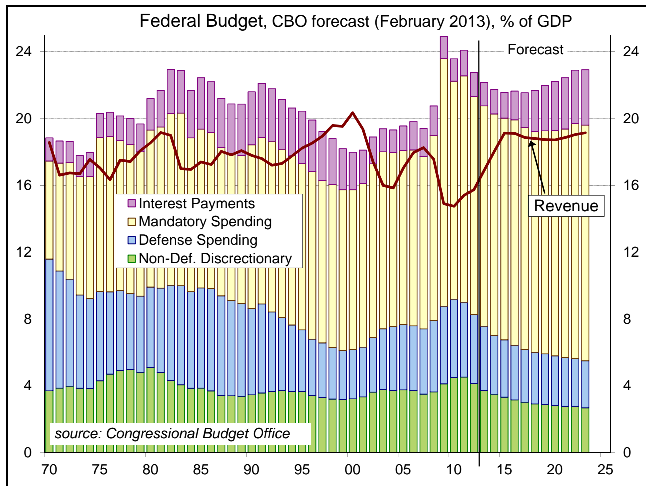
Job losses in state and local government were unusually large in 2010 and 2011, but appeared to flatten out last year. The economic recovery has led to a gradual rebound in tax receipts, which has reduced budget strains. It's unlikely that state and local governments will make much of a positive contribution to jobs in 2013, but they aren't likely to subtract.

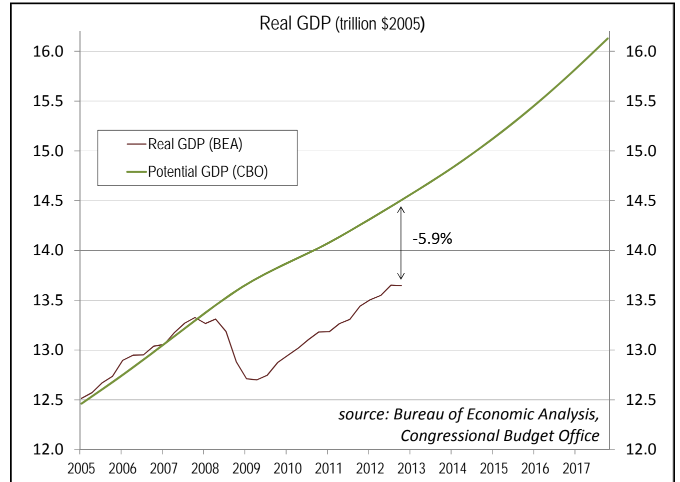
Job losses at the federal level will pick up if the sequester goes into effect. However, federal government payrolls are about one-seventh the size of state and local government payrolls. Still, a lot depends on when federal budget cuts will begin and where they will fall.

As it stands now, the sequester would subtract $85 billion from government spending this year (or 0.7% of GDP, not counting multiplier effects). President Obama has proposed that the sequester be postponed to the start of next year. Kicking the can down the road would not be costless. The two month delay (from January 1 to March 1) had to be "paid for" with revenue increases and cuts to other spending.

The federal debt ceiling was breached on December 31, with a drop dead date seen in the second half of February. However, lawmakers have agreed to postpone the debt ceiling limit until May 19. This will allow time to come up with a grand bargain to reduce the deficit over the long run. However, achieving a broad budget agreement is likely to prove elusive.

© 2013 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. All rights reserved.
All expressions of opinion reflect the judgment of the Research Department of Raymond James & Associates, Inc. (RJA) as of the date stated above and are subject to change. Information has been obtained from third-party sources we consider reliable, but we do not guarantee that the facts cited in the foregoing report are accurate or complete. Other departments of RJA may have information that is not available to the Research Department about companies mentioned in this report. RJA or its affiliates may execute transactions in the securities mentioned in this report that may not be consistent with the report's conclusions.





Updated projections from the bipartisan Congressional Budget Office, released in early February, factored in the American Taxpayer Relief Act of 2012 (the fiscal cliff deal). The CBO expects the deficit to fall to $845 billion in FY13 (ending in September) or 5.3% of GDP, falling to $430 billion in FY15 (or 2.5% of GDP). From there, the deficit begins to rise again, partly reflecting the impact of higher interest rates (as the economic recovery picks up steam). As with any forecast, the CBO's projections are subject to a number of uncertainties, but the outlook does not justify the current hysteria about the deficit. Demographic pressures will generate budget strains over the long term, but there's plenty of time to address that.

Failure to stick to budget restraint would add to the deficit in the years ahead. Base-broadening tax reform could add to revenues. The biggest factor for the deficit in the near term will be economic growth. Faster economic growth would lead to a more rapid recovery in tax receipts. Spending cuts (the sequester) would subtract from overall GDP growth.

Many of the headwinds restraining economic growth should continue to fade in 2013. Housing is picking up. Replacement needs will continue to drive motor vehicle sales. State and local government should be less of a drag. Unfortunately, some headwinds will linger. The increase in payroll taxes will dampen consumer spending growth in the near term. Bank credit is getting gradually easier, but is still relatively tight. The global economy is soft. Exports were a source of strength in the early part of the economic recovery, but the trend flattened in 2012. There is a potential for much stronger GDP growth at some point (2014?) as slack is taken up.

Minutes of the December Federal Open Market Committee meeting showed that "several" monetary policymakers were worried that the Fed's asset purchases might generate financial instability. These concerns weren't apparent in the January 30 policy statement, but should show up in the minutes (due February 20). The Fed is likely to continue its asset purchases for most (if not all) of this year.

	1Q12	2Q12	3Q12	4Q12	**1Q13**	**2Q13**	**3Q13**	**4Q13**	**1Q14**	**2Q14**	2012	**2013**	**2013**
GDP (↓ *contributions*)	2.0	1.3	3.1	**1.4**	**1.4**	**1.6**	**2.8**	**2.9**	**2.9**	**3.0**	**2.3**	**1.9**	**2.8**
consumer durables	*0.9*	*0.0*	*0.7*	***0.8***	***0.2***	***0.2***	***0.3***	***0.3***	***0.3***	***0.3***	***0.6***	***0.4***	***0.3***
nondurables & services	*0.9*	*1.1*	*0.5*	***0.8***	***0.6***	***0.6***	***1.4***	***1.5***	***1.5***	***1.5***	***0.8***	***0.8***	***1.4***
bus. fixed investment	*0.7*	*0.4*	*-0.2*	***0.4***	***0.6***	***0.5***	***0.7***	***0.9***	***0.9***	***0.9***	***0.7***	***0.5***	***0.8***
residential investment	*0.4*	*0.2*	*0.3*	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***	***0.3***
government	*-0.6*	*-0.1*	*0.8*	***-0.3***	***0.1***	***-0.4***	***-0.2***	***-0.1***	***0.0***	***0.0***	***-0.3***	***0.0***	***0.0***
Domestic Final Sales	2.2	1.4	1.9	**2.0**	**1.7**	**1.2**	**2.6**	**2.9**	**3.0**	**3.0**	**2.0**	**1.9**	**2.8**
exports	*0.6*	*0.7*	*0.3*	***-0.4***	***-0.2***	***0.2***	***0.4***	***0.4***	***0.5***	***0.6***	***0.5***	***0.1***	***0.5***
imports	*-0.5*	*-0.5*	*0.1*	***0.2***	***0.2***	***0.4***	***-0.2***	***-0.5***	***-0.6***	***-0.6***	***-0.5***	***0.1***	***-0.5***
Final Sales	2.4	1.7	2.4	**1.8**	**1.7**	**1.8**	**2.7**	**2.8**	**2.9**	**2.9**	**2.0**	**1.7**	**2.7**
ch. in bus. inventories	*-0.4*	*-0.5*	*0.7*	***-0.4***	***-0.3***	***-0.2***	***0.0***	***0.0***	***0.0***	***0.1***	***0.2***	***-0.1***	***0.0***
Unemployment, %	8.2	8.2	8.0	7.8	**7.9**	**7.8**	**7.6**	**7.5**	**7.3**	**7.2**	8.1	**7.7**	**7.2**
NF Payrolls, monthly, th.	226	67	168	151	**100**	**115**	**150**	**175**	**185**	**190**	153	**135**	**190**
Cons. Price Index (q/q)	2.5	0.8	2.3	**2.1**	**0.9**	**1.9**	**1.9**	**2.0**	**2.0**	**2.0**	**2.1**	**1.7**	**2.0**
excl. food & energy	2.1	2.6	1.5	**1.7**	**1.6**	**1.8**	**1.9**	**2.0**	**2.0**	**2.0**	**2.1**	**1.8**	**2.0**
PCE Price Index (q/q)	2.5	0.7	1.6	**1.4**	**1.1**	**1.8**	**1.8**	**1.9**	**1.9**	**1.9**	**1.7**	**1.5**	**1.9**
excl. food & energy	2.2	1.7	1.1	**1.0**	**1.5**	**1.7**	**1.8**	**1.8**	**1.9**	**1.9**	**1.7**	**1.5**	**1.8**
Fed Funds Rate, %	0.10	0.16	0.15	0.16	**0.15**	**0.15**	**0.16**	**0.17**	**0.18**	**0.19**	0.14	**0.16**	**0.20**
3-month T-Bill, (bond-eq.)	0.1	0.1	0.1	0.1	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**	**0.2**	0.1	**0.1**	**0.2**
2-year Treasury Note	0.3	0.3	0.3	0.3	**0.3**	**0.3**	**0.4**	**0.5**	**0.7**	**0.8**	0.3	**0.4**	**0.9**
10-year Treasury Note	2.0	1.8	1.6	1.7	**1.7**	**1.7**	**1.8**	**2.0**	**2.1**	**2.2**	1.8	**1.8**	**2.2**

© 2013 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC.

International Headquarters:
The Raymond James Financial Center | 880 Carillon Parkway | St. Petersburg, Florida 33716 | 800-248-8863
RAYMOND JAMES