

The **Panic of 2008** led to a sharp contraction in the US economy last winter. But by mid-year 2009, the US economy got back on the growth path. Real GDP growth spiked 5.7% in the final quarter of 2009, the fastest pace since 2003.

Despite this spike in growth, and a drop in the unemployment rate, pessimism is still prevalent. Many economists argue that fourth quarter growth was a function of inventory building, not real growth. This past weekend, former Federal Reserve Chairman Alan Greenspan said the recovery in 2010 will be "trudging."

We think these pessimists are wrong and that Greenspan is just too dour. First the inventory issue: the US has just been through the mother-of-all inventory reductions. Relative to the size of the economy, last year's (inflation-adjusted) inventory decline of \$112 billion was more than twice as large as any other inventory reduction since 1950. In the fourth quarter inventories still declined – that's right they *declined*. But because they declined by less than they had in the third quarter, they added to GDP growth. In other words, the inventory cycle necessary to replenish store shelves has just begun. In fact, there are signs of a V-shaped, industrial-led recovery all over.

The ISM Manufacturing Index hit 58.4 in January, higher than anytime during the late-1990s boom. New orders for "core" capital goods, a gauge of business investment in equipment, are up at a 15% annual rate in the past three months. And even with troubles at Toyota and a hangover from the "cash-for-clunkers" program, January auto sales are up 11% versus June, just before the clunkers program got started.

If Greenspan was correct, and a trudging recovery was all we could hope for, the inventory building would end quickly because there would be little consumer follow through. But real consumer spending grew at a 2.4% annual rate in the second half of 2009. Don't be fooled by anyone who says this was all cash-for-clunkers - excluding autos, real consumption increased at a 2.3% rate. And the future looks bright.

In the past three months, real personal income, *excluding transfer payments*, is up at a 2.1% annual rate. And

in the past three months, civilian employment is up an average of 110,000 per month. Although private-sector payrolls are down an average of 20,000 per month, the workweek is getting longer. The increase in total hours worked is the equivalent of adding 200,000 jobs per month. In other words, the demand for labor is there, it's just that firms are temporarily meeting it by increasing hours. Either way, more labor demand will turn into more consumer buying power and more growth.

Meanwhile, consumer debt, rent, and mortgage payments are falling. Our calculations show that the financial obligations ratio is now the lowest in about ten years. This is the share of after-tax income that consumers need to service their debts and make other recurring payments, such as rent and car leases.

Add it all up and our forecast for 4.5% real GDP growth in 2010 doesn't look so far-fetched anymore. Notwithstanding Alan Greenspan, the data this winter has encouraged many economists to raise their economic growth forecasts for the US.

One key reason for our optimism is the stance of monetary policy. Fed policy is clearly loose, and will get even looser as the economy picks up.

Nominal GDP – real growth plus inflation – is up just 0.4% at an annual rate in the past two years. This makes current interest rates appear reasonable. But nominal GDP grew at a 2.6% annual rate in the third quarter and at a 6.4% pace in Q4. With nominal GDP continuing to rebound strongly, the point of "maximum looseness" in monetary policy – when the funds rate is farthest below the trend in nominal GDP growth – might come well *after* the Fed has started raising rates.

As a result, with the normal lag, the economy will continue to be boosted by easy money well into 2011. This does not mean that tax hikes next year (if they actually come) won't hurt. Tax hikes always undermine the economy. But loose money can overwhelm them in the short-run. This is what happened in 1993-94, when the negative impact of Clinton's tax hikes were offset by Greenspan's easy money.

In other words, this is a very normal, self-sustaining, V-shaped economic recovery.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-10 / 7:30 am	Int'l Trade Balance - Dec	-\$35.5 Bil	-\$34.4 Bil		-\$36.4 Bil
1:00 pm	Treasury Budget - Jan	-\$46.0 Bil	-\$46.0 Bil		-\$91.9Bil
2-11 / 7:30 am	Retail Sales - Jan	+0.3%	+0.5%		-0.3%
7:30 am	Retail Sales Ex-Autos - Jan	+0.5%	+0.9%		-0.2%
7:30 am	Initial Claims - Feb 6	465K	467K		480K
7:30 am	Business Inventories - Dec	+0.3%	+0.3%		+0.4%
2-12 / 8:45 am	U. Mich. Consumer Sentiment	75.0	75.0		74.4

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security. This document contains forward-looking statements about various economic trends and strategies. You are cautioned that such forward-looking statements are subject to significant business, economic and competitive uncertainties and actual results could be materially different. There are no guarantees associated with any forecast and the opinions stated here are subject to change at any time and are the opinion of the individual strategist. Data comes from the following sources: Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis, the Federal Reserve Board, and Haver Analytics. Data is taken from sources generally believed to be reliable but no guarantee is given to its accuracy.