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ECONOMICS: US PERSPECTIVES—JANUARY 21, 2011

New Mix Growth Story Is Intact

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A look back at 2010 confirms a dramatic shift in the sectors that are driving the US economic cycle. Investment is likely to play a leading role in the quarters ahead as US firms plan a large investment spree, while exports should continue to be powered by strong demand from emerging markets.

The US economy ended 2010 on a strong note, with consumer spending posting a surprising rebound late in the year. But a closer look at the forces behind gross domestic product (GDP) growth shows that the US economic recovery is still being predominantly fueled by exports and investment spending. In our view, this new mix of growth drivers will continue to shape the recovery in the years ahead.

In the fourth quarter of 2010, real GDP expanded by about 3.6% annualized, according to our estimates—one percentage point faster than the US economy's third-quarter gain. Real consumer spending rose by an estimated 3.8% in the fourth quarter, the strongest annualized quarterly gain of the current cycle.

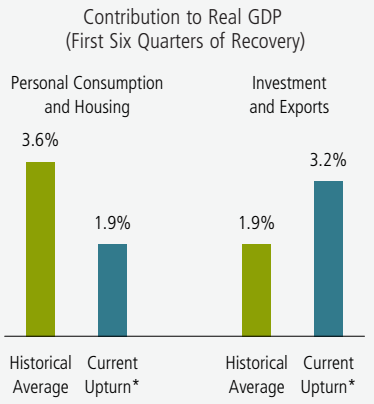
At the same time, business spending on capital equipment and software increased by an estimated 11% annualized, while exports probably gained between 9% and 10%. When the final numbers are in, we expect a 15.5% gain in capital spending for 2010, and a 12% increase for exports—their strongest years since 1984 and 1988 respectively.

Investment and Exports Fuel Growth

Throughout the recovery, we've argued that the dynamics of US economic growth were changing dramatically. Historically, the US economy has advanced 5% on average during the first six quarters of recovery from recessions over the past 50 years. These cycles were typically driven by consumption and housing, which together accounted for 3.6 percentage points of the total gain in real GDP. Yet even after the strong rebound in late 2010, consumer spending and housing contributed 1.9 percentage points to GDP growth during the first 18 months of the current recovery, a little more than half of the historical average **(Display 1)**.

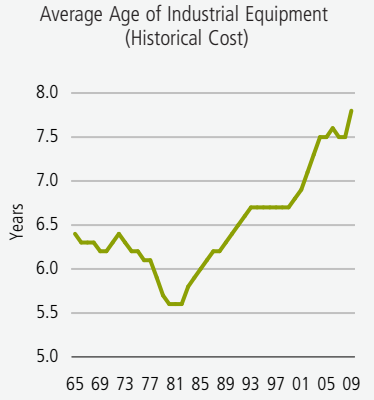
In contrast, investment and exports have contributed almost twice the historical average since the start of the recovery in the third quarter of 2009, adding 3.2 percentage points to GDP growth. It marks the first time in the postwar era that these

Display 1
New Mix of Growth Persists



As of December 31, 2010
*Annualized change for six quarters from 2Q:2009
Source: Bureau of Economic Analysis and AllianceBernstein

Display 2
Compelling Reasons for US Firms to Invest



As of December 2009
Source: Bureau of Economic Analysis and Haver Analytics

two sectors of the economy have played a bigger role than consumption and housing in a US economic recovery. And our research suggests that this trend will continue through 2011, with investment and exports poised to account for the lion's share of growth.

Companies Plan Spending Spree

American businesses are planning massive investments, according to several recent business surveys, including the CEO Business Roundtable and the semiannual survey of manufacturing purchasing managers. Companies across sectors are beginning to disclose details of their aggressive investment plans. For example, Union Pacific Railroad said in November that it was planning to increase capital spending by 25% in 2011 to invest in its railroad network and other projects. Earlier this month, Intel announced a huge investment spree in 2011, with spending rising by 73% to $9 billion for projects including a new semiconductor fabrication plant in Oregon. Meanwhile, Ford Motor plans to invest $400 million to build a new full-size transit van at its plant in Missouri, according to a January 18 announcement.

We think there's much more to come. In the weeks ahead, US firms will release fourth-quarter earnings reports and discuss the outlook for 2011. At this writing, we estimate a 15% rise in business spending on capital equipment and software and a 5% gain in nonresidential structures. Both figures may prove conservative in light of a huge need to rebuild and expand the industrial capital stock in the US, as the average age of industrial equipment is the highest in the postwar period **(Display 2, previous page)**.

Exports are also accelerating rapidly. Strong growth in emerging markets continues to drive US export growth, accounting for a record 56% of overall US merchandise exports in November **(Display 3)**. These gains would have been even stronger had there not been ongoing weakness in commercial aircraft deliveries. Amid ongoing production delays at Boeing, exports of commercial aircraft and engines for 2010 fell by 6.5% from 2009 and now account for less than 5% of total real merchandise exports—the lowest share on record. But the good news is that export orders for commercial aircraft remain strong, and Boeing announced that after several delays, it expects to make its first deliveries of the new 787 wide-body commercial jet in the third quarter, with as many as 15 models for export likely to be delivered this year. If exports of big-ticket commercial aircraft rebound in 2011, our 9% growth estimate for overall exports may prove too conservative.

Three Stages for New Mix Shift

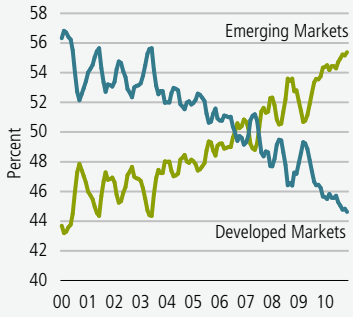
In our view, the US economy is still in the early stages of a capital expenditures and export boom. It's worth remembering that macroeconomic cycles are multifaceted and extremely dynamic. Often, factors that didn't exist when the recovery began will surface and add another leg or two to the growth cycle.

The early stages of the current investment and export cycle were driven by a recovery of domestic demand in emerging markets, which fueled the global rebound. US firms, having improved productivity over the past decade **(Display 4)**, were well positioned to tap into fast-growing markets in emerging economies. In turn, this helped lift US growth, directly and indirectly, through exports and capital spending.

What will the next chapter of this cycle look like? In our view, US manufacturers will increasingly realize that they must upgrade their aging capital stock to maintain their competitive edge globally and boost production. Recent moves by companies like Intel and US automakers reflect an awareness of the need to invest and innovate. In the third chapter, we envision the US export recovery broadening to industries such as commercial aircraft, new technology and consumer goods. This would be driven by continued growth of a strong middle class in emerging markets, with rising incomes fostering new needs and tastes for products designed and made in the US.

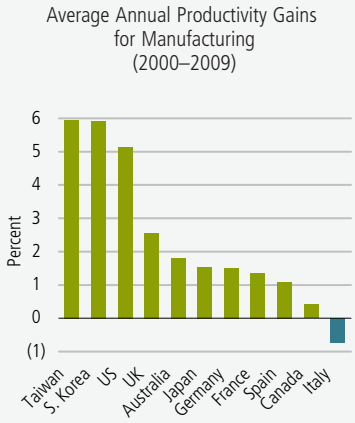
Clearly, the new mix thesis will not follow a linear path, but we believe there are many domestic and global forces at work that will accumulate over time to shed light on the dynamic shift in the main sources of US growth. These changes will have important implications for investors as capital flows back toward the more productive segments of the US economy. ■

Display 3
Emerging Markets Fuel US Export Boom



As of November 2010
Source: Census Bureau and Haver Analytics

Display 4
US Firms Positioned for Export Growth



As of December 2009
Source: Bureau of Labor Statistics and AllianceBernstein