Fixed Income Insight
First Quarter 2012
January 24, 2012

➔ **The economic expansion continues in the United States.**

- Headline GDP growth came in at a 1.8% annual rate in the third quarter, up slightly from the paltry pace it had sustained in the first half of the year. However, other measures of domestic activity continue to run well above that pace, suggesting the expansion that began in June of 2009 is still in place.
- Helped by a rebound in durable goods spending, Personal Consumption Expenditures made a strong contribution to third quarter growth.
- Business Fixed Investment moved ahead over the course of 2011, but almost all of the gains came from equipment and software spending. Construction-related activity, be it residential or commercial, remains weak.
- Government spending continues to be a drag on overall growth as fiscal conditions at all levels remain under duress. Resolution of the Federal budget issues was postponed by the failure of the Super Committee to propose any concrete actions.

➔ **The employment situation continues to perplex.**

- Private payroll employment continued to move ahead through the fourth quarter. As of December, we have added 3.1 million private sector jobs since the trough in employment in February 2010. However, this is only slightly more than half of the more than 6 million jobs lost during the recession and its aftermath.
- State and Local payrolls, meanwhile, continue to shrink with almost 700,000 jobs lost since the trend turned downward in 2008.
- Underemployment continues to be a concern. While the broadest measure of unemployment, U-6, has recently shown some improvement, the fact that it is still within hailing distance of its cycle-high of 17.2% in a recovery that is now more than two years old is an indication of how difficult it has become to attain any real improvement in employment conditions.
- A further reflection of the changes in the unemployment situation in this recovery is the fact that the long-term unemployed – those out of work for 27 weeks or more – are now the largest cohort in the ranks of the jobless.

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Please refer to Notes and Disclosures on page 2.

- **Inflation remains a concern.**
  - Despite some abatement in energy prices, both the Consumer Price Index and the Personal Consumption Expenditures Price Index remain elevated.
  - Perhaps because of concerns over the stability of world credit markets, as well as the viability of the domestic economic recovery, the Federal Reserve has had little to say about the changing inflation dynamic.
  - Shelter costs, which had been helping to restrain the rise of the major price indexes, have accelerated reflecting the strength of the residential rental market.
  - Nonetheless, it is difficult to envision sustained demand pull or cost push inflation pressure with sluggish/modest economic growth, weak employment growth, high unemployment and excess capacity.
- **Public finances, both here and abroad, come under intense scrutiny.**
  - The United States saw its credit rating lowered to AA+ in the midst of a debate over the debt ceiling. The gridlock and brinksmanship of the budget negotiators sparked concern that there would be no serious consideration of a solution to the current budget imbalance.
  - Debate continues over the resolution of the Greek debt owned primarily by European banks. Hopes are rising that a more lasting solution may be reached under the aegis of the European Central Bank. The downgrade of eight European nations, including France, by S&P in the first quarter of 2012, could pose additional risk to the backup support for the ECB.
  - State and local finances remain stressed and further austerity measures are likely. Debate over the Federal budget is scheduled to resume in February when the temporary measure on unemployment benefits expires.

Notes and Disclosures