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Transitory Gloom Clouds Deere Boom as U.S. Shows Resilience (1)
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(Updates with S&P 500 Index futures in ninth paragraph.)

By Timothy R. Homan and Shobhana Chandra

June 27 (Bloomberg) -- The strength of the U.S. economy depends on whether you believe optimists like Mark Zandi or pessimists like David Rosenberg.

Economists Zandi and Neal Soss, who project sustained growth during the next six months, agree with Federal Reserve Chairman Ben S. Bernanke that the recent slowdown in consumer spending, manufacturing and gross domestic product will be transitory. They point to two years of expansion in the world's largest economy and rising corporate profits as signs that GDP is poised to pick up.

The U.S. is "measurably stronger today than a year ago," said Zandi, chief economist for Moody's Analytics Inc. in West Chester, Pennsylvania. "You can see it in the job market. At that time, job growth had just started to resume; now 2 million private-sector jobs have been created."

Rosenberg and Ethan Harris predict the U.S. will struggle as some fiscal-stimulus programs end and federal, state and local governments continue to slash budgets. Companies aren't likely to use their record earnings to accelerate hiring, the economists say, while no one knows exactly how long it will take to resolve the European debt crisis and repair factories in Japan following the earthquake and tsunami.

"To say that the air pocket that we hit in the first quarter was all transitory is a mistaken view," said Rosenberg, chief economist at Gluskin Sheff & Associates Inc. in Toronto.

"The whole recovery's been a soft patch." Another recession "is practically baked in the cake, barring another round of policy stimulus."

More Resilience

Investors see more resilience, particularly for manufacturers such as Deere & Co. that will gain from domestic sales and exports. The reversal of temporary restraints such as supply disruptions from Japan and a spike in oil prices means "we'll not just go from the negatives to neutrals but from the negatives to positives" in the second half of this year, said James Paulsen, chief investment strategist at Wells Capital Management. That will boost share prices, especially for industrial, technology and emerging-market companies, he said.

"The stock market is going to be higher as expectations about economic growth go from 2 percent to 3 percent to 4 percent," said Paulsen, whose Minneapolis-based company oversees about \$340 billion. "It might take until August before we see a firm turn in the economic data. The market is going to start to pick that up around July."

Fund Gain

The Industrial Select Sector SPDR Fund, an exchange-traded fund including Moline, Illinois-based Deere and Caterpillar Inc. in Peoria, Illinois, has climbed 23 percent in the 12 months to June 24, outpacing an 18 percent rise in the broader Standard & Poor's 500 Index of stocks.

S&P 500 Index futures rose 0.1 percent to 1,265.30 at 9:37 a.m. in London today.

Deere, the world's largest farm-equipment maker, raised its 2011 earnings forecast in May to \$2.65 billion for the year through October from a \$2.5 billion estimate in February. U.S. and Canadian farm-machinery sales may increase as much as 10 percent this year and construction-equipment shipments are growing, with the U.S. at the start of a rebound, Deere said.

Similar gains are expected in foreign markets, with sales of farm gear forecast to rise about 15 percent in the European Union, Deere said. That outlook comes on the heels of record U.S. exports in April.

'Optimistic'

"Markets for construction equipment in the U.S. and for farm machinery in Europe are in the early stages of recovery," Samuel Allen, Deere's chairman and chief executive officer, said in a May 18 statement. "We're optimistic about the longer-term opportunity for further improvement in these and other key areas."

Two years after the 18-month recession ended in June 2009, the expansion is "continuing at a moderate pace, though somewhat more slowly" than anticipated, Fed policy makers led by Bernanke said on June 22 after a two-day meeting in Washington.

That "reflects, in part, factors that are likely to be temporary, including the damping effect of higher food and energy prices on consumer purchasing power and spending, as well as supply-chain disruptions associated with the tragic events in Japan," the Federal Open Market Committee said in its statement.

Slow Healing

The weak rebound so far "means the wounds heal very slowly, said Harris, head of developed-markets economic research at Bank of America Merrill Lynch in New York. He also is concerned about Democratic and Republican wrangling over the record \$1.6 trillion federal deficit. Congress may settle for a "front-loaded debt-reduction plan," which the economy "cannot handle," he said.

Another unknown is the success of a rescue package that EU leaders are working on to stave off a Greek default.

"Greece and the fiscal impasse in the U.S. are huge wild cards, with tremendous uncertainty about how long they last," said Harris, a former manager of the Federal Reserve Bank of New York's research division. They're "a psychological headwind that restrains the stock market and makes everyone a little more nervous about the world."

A deceleration in growth to 1.9 percent in the first quarter from 3.1 percent in the previous three months highlights how vulnerable the U.S. still is, Harris said. Setbacks such as higher energy prices are "small shocks" the economy would "motor through" in better times, "but in the current environment, it doesn't take a lot to convince companies and consumers to pull back," he said.

Rising Unemployment

Payrolls grew in May at the slowest pace in eight months, and the unemployment rate unexpectedly climbed to 9.1 percent from 9 percent in April and 8.8 percent in March, according to Labor Department figures. While private employers have added 2.14 million workers since hiring resumed in March 2010, the recession caused the loss of about 8.8 million jobs.

Soss, a former New York Fed economist and now chief economist at Credit Suisse in New York, said he expects improvement in the labor market later this year that may strengthen consumer spending, which accounts for about 70 percent of GDP.

Household purchases will rise at a pace that "will be enough to give us moderate growth," he said. "Compared to this time last year, the economy is on safer ground. That is good news from the point of withstanding a shock."

Straddle Both Sides

Soss projects expansion of 2.8 percent this year and 3.9 percent in 2012, while Zandi's forecast is 2.7 percent and 4.2 percent. Harris predicts growth of 2.4 percent for 2011 and 3 percent next year. Rosenberg said he sees 1.5 percent this year and "near zero" for 2012.

Bernanke straddled both sides of the debate between the optimists and pessimists during his press conference after last week's Fed meeting.

"It's an appropriate balance to attribute a slowdown partly to these identifiable temporary factors, but to acknowledge the possibility that some of the slowdown is due to factors which are longer-lived," he said in response to a reporter's question. At the same time, "we will see greater growth going forward."

Some of the shocks already are waning. Crude oil for August delivery was \$91.16 a barrel as of June 24, down from this year's peak of \$113.93 April 29. That means consumers are getting relief at the pump. The average price of a gallon of regular gasoline fell to \$3.60 on June 23, from \$3.99 on May 4, the highest since July 2008, according to AAA, the nation's largest auto club.

Export Demand

Manufacturing, which grew last month at the slowest pace in more than a year, is poised to rally in the second half as Japanese companies recover from the March earthquake and tsunami, easing a parts shortage, Zandi and Soss said. Exports also are showing strength, helped by rising demand in markets such as China, the world's fastest-growing major economy.

Shipments climbed 1.3 percent to a record \$175.6 billion in April, according to Commerce Department data. The value of the dollar has fallen 8.5 percent in the past 12 months against a trade-weighted basket of currencies from America's biggest trading partners. This makes U.S.-made goods cheaper for overseas buyers.

While manufacturing jump-started the rebound, the expansion has become more broad-based, allowing corporate America to repair its finances. Companies in the S&P 500 had \$2.58 trillion in cash and short-term investments at the end of the first quarter, according to data compiled by Bloomberg.

"It's no longer a question of can businesses invest and hire?" Zandi said. "It's a question of willingness. That's a big distinction. I could not have said that a year ago."

Under Construction

Some companies are adding both machinery and workers. Caterpillar, the world's largest maker of construction equipment, said this month it will spend an additional \$70 million at a hydraulic-excavator plant under construction and add about 100 jobs to the 500 originally planned for the Victoria, Texas, facility. Production is slated to begin in mid-2012, according to a June 17 statement from the company.

The outlook for the next three to six months, as measured by the index of leading indicators from the Conference Board, underscores the optimists' view. The gauge rose 0.8 percent in May, exceeding the 0.3 percent median forecast in a Bloomberg survey and following a drop the prior month.

"Cyclically, the economy is continuing to grow," Soss said, adding that he hopes for even faster progress. "It's the difference between doing better and doing well," he said.

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