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Can the Economy Recover in 2011? by [Prince Damin](#)

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Before you get too excited, I'm not planning on throwing my hat in the ring with my own predictions for the economy next year. I find plenty of ways to be wrong, and that is the kind of make-me-look-silly opportunity that I'm more than happy to pass on. Of course if that's what you're looking for, plenty of other more daring (foolhardy?) individuals have provided guesses. Jan Hatzuis at Goldman Sachs (NYSE: GS), for instance, pegs U.S. GDP growth at 3.4% for 2011. Mohamed El-Erian and the folks over at PIMCO see growth in a range of 3% to 3.5%. And Nouriel "Dr. Doom" Roubini has predicted a 2.7% growth rate. In lieu of adding my own guess to the mix, I thought I'd look at three areas that will be keys for the economy in the year ahead: The consumer, employment, and banking.

**The consumer:-** As we're all-too-well aware, consumers make up roughly 70% of the U.S. economy. While consumption spending actually tends to be a more stable economic contributor, the hefty contribution is worrisome during a recession like this one where consumers get the America's Funniest Home Videos whiffleball bat in the groin treatment. If you ask consumers how they're doing, they're not going to give you a terribly encouraging answer. Sentiment measures like the University of Michigan's survey still show consumer sentiment well below prerecession levels. But what consumers say may be a bit of a backward-looking indicator. The post-dot-com recession was deemed over in late 2001 and yet the U of M's measure didn't bottom out until early 2003.

In the meantime, consumers have been doing some pretty interesting things. For one, they've reduced their borrowing. Total consumer credit and consumer credit as a percentage of GDP are still up significantly over the past decade, but they've taken a definite dip downward over the past couple of years. That, along with ridiculously low interest rates, has brought household debt service ratios down to levels we haven't seen in more than a decade. People have also significantly upped the amount they're saving. But from the economy's perspective, what really matters is how much consumers are spending. And on that count they've mounted a significant recovery. Real PCE during the third quarter was \$9.3 trillion (annualized), just 0.1% lower than the 2007 peak. Looking ahead to 2011, we'll definitely want to keep an eye on consumers, but we may want to focus on what they're doing rather than what they're saying.

**Employment:-** It's tough to talk about consumers without mentioning employment. For obvious reasons, employment is a key driver of consumers' ability to spend. Unfortunately, the employment picture has been particularly ugly. Everybody tends to focus on the unemployment rate, which I think is one of the poorest measures we have of employment. One measure that I find much more interesting is the employment/population ratio: the number of employed persons as a percentage of the total population. It looks pretty dismal. A more timely indicator is initial unemployment claims. We've seen movement there in the right direction, but the measure has fallen to a level that's still pretty consistent with where it was during the economic downturn early in the decade.

Are you ready for the good news? Well so am I, so if you have some, pass it along. It's going to be difficult to continue the economic recovery if companies don't start hiring. Looking to next year, we need layoffs to slow, new (permanent) jobs to be created, and frustrated workers to get unfrustrated enough to re-enter the labor force.

**Banking:-** I happen to think there are investment opportunities in the banking sector. However, I'm under no illusion that the sector has left its problems in the past. To see what I mean, you don't have to look any further than the current delinquency rates on real estate loans at U.S. banks. The third quarter of this year was the first quarterly decline in delinquency rates since the first quarter of 2006. That may be a positive development, but it's still an ugly scene. And while reports from

foreclosure specialist RealtyTrac show a slowdown in foreclosures, recent activity has likely been put on ice thanks to the robo-signing debacle. Even so, one in every 492 houses in the U.S. received a foreclosure filing during November.

But there may be more positive notes for the banking industry. The government seems to see steadier footing at least at the top of the food chain, as it unloads its investment in Citigroup(NYSE: C). There have also been rumors that banking regulators may see fit to allow banks like Wells Fargo (NYSE: WFC) and JPMorgan Chase (NYSE: JPM) to raise their dividends. And a spate of recent banking buyouts including Bank of Montreal taking out Marshall & Ilsley (NYSE: MI), Hancock Holding buying Whitney Holding (Nasdaq: WTNY), and Toronto Dominion (NYSE: TD) snapping up Chrysler Finance may be the beginning of a deal surge that could provide struggling banks with needed financial backing. Looking to the year ahead, it doesn't seem there's any quick fix for the real estate markets that have been giving banks' such headaches. So the key for the banks will be managing their balance sheets and finding ways to keep their capital at healthy levels.

Forecasters: good luck:- As 2010 closes out, many forecasters have been getting more optimistic about the year ahead. As an optimist, I would like to think that they're right. But if one thing is all too clear, it's that the U.S. economy still has quite a climb to get back to anything that resembles normal.

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