

VAKIFBANK GLOBAL ECONOMY WEEKLY

**Which course will the US economy
follow for the rest of 2011?**



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In spite of the economic slowdown in the first quarter of 2011, macro economic data indicates the US economic recovery will continue in the second quarter...

US economic growth slowed 1.8% in the first quarter of 2011 from 3.1% in Q4 2010.

The reasons of the slowdown:

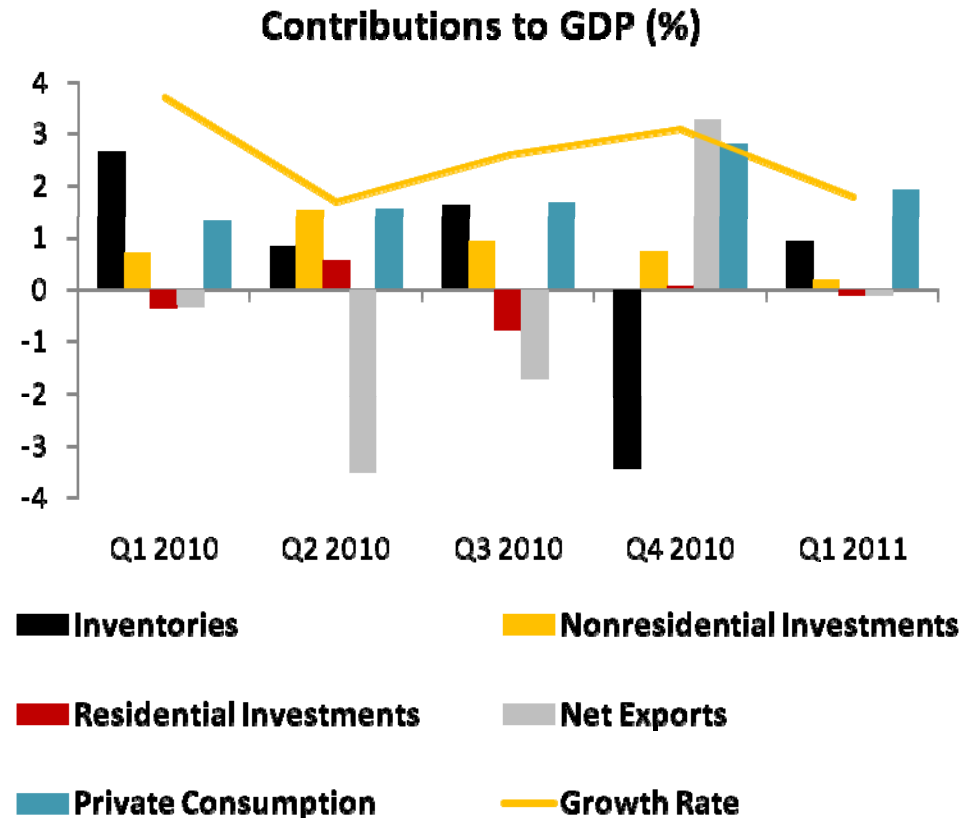
- The rising inflation dampened private consumption,
- Construction investment was delayed due to the bad weather conditions,
- Government sector cut spending such as defense spending.

On the positive side in spite of these reasons, macro economic data indicates the US economic recovery will continue. The reasons for this expectation examined in detail in this study.

US economy in the first quarter of 2011 grew 1.8% below the expectations...

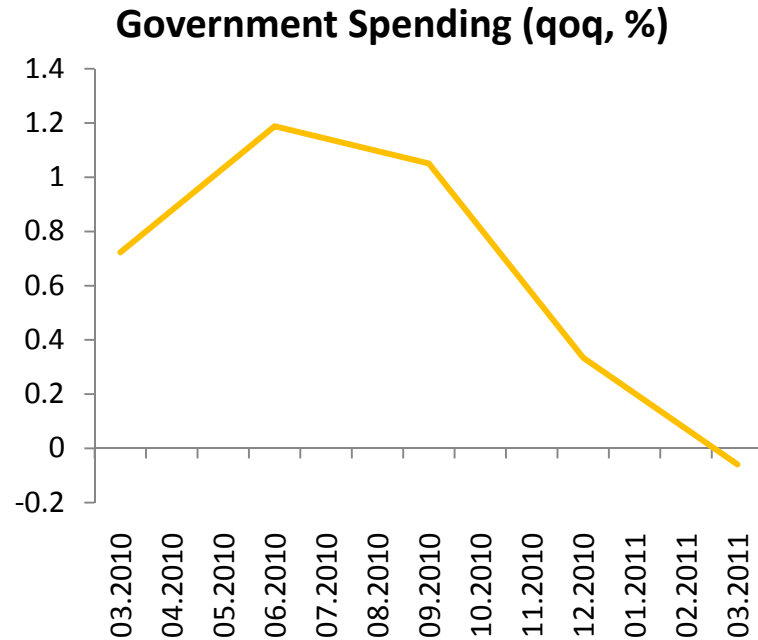
- ✔ The drop in residential investments due to bad weather conditions and the strong trend at the food and oil prices acted as a damper on the economic growth level.

- ✔ Private consumption, has the highest share in GDP, dropped to 2.7% from 4%. In January 2011 cut in social security taxes did not affect the private consumption apparently.



Source: Bloomberg

Cut in government spendings, decreasing personal consumptions and fall in net exports negatively affected Q1 GDP...



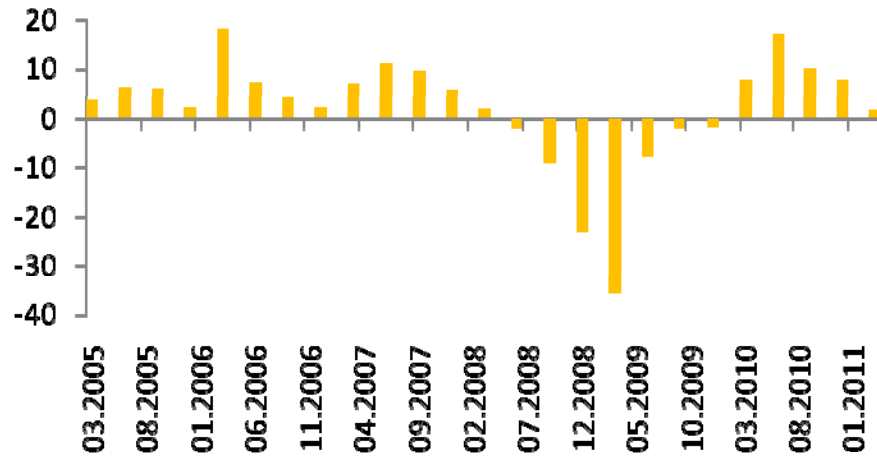
Source: Bloomberg

- Another reason of the economic slowdown in Q1 2011 was government sector cut spendings such as defense spending. These spending cuts reduce the real GDP for about 1%.
- Moreover, decreasing personal consumptions and fall in net export negatively affected the growth rate.
- As a result of these factors, the growth rate is not strong enough to support the labor market.

- Earthquake and nuclear disaster have negative impacts on the production activities in Japan and it may negatively affect the global supply chain.
- Reduction of production in Japan which is an important supplier especially in electronic equipments, arises a risk for the production activities in US as a net importer from Japan.
- Moreover, reduction in supply will cause a risk for the prices upwardly. Hence this situation may have negative impacts on growth performance of US.

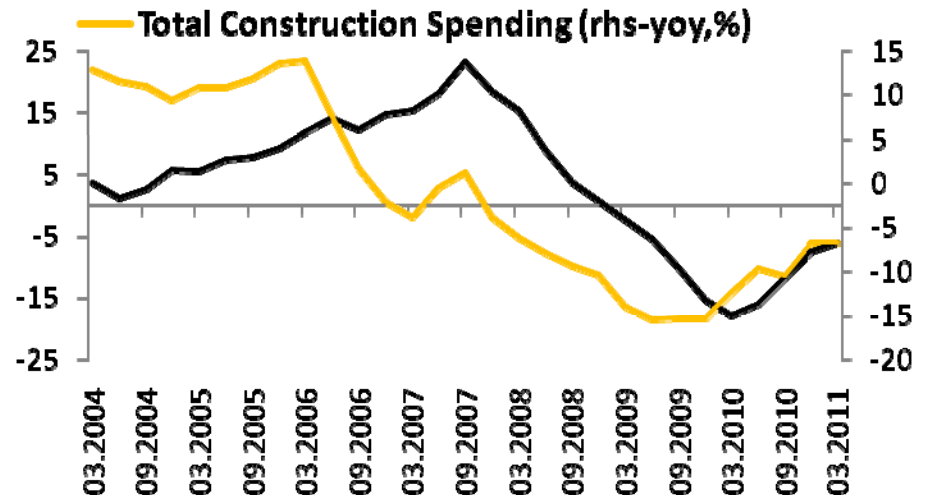
Decrease in nonresidential fixed investment was another factor for low US growth rate...

Nonresidential Fixed Investment (%)



Source: Bloomberg

Nonresidential Construction Spending (yoy, %)



Source: Bloomberg

With the recovery in 2010, nonresidential fixed investment increased 17.2%. This was the highest level since 2006. However this investment started to decrease since Q2 2010.

Nonresidential fixed investment decreased sharply from 7.7% to 1.8% in Q1 2011. This is another reason in the slowdown of the US growth rate.

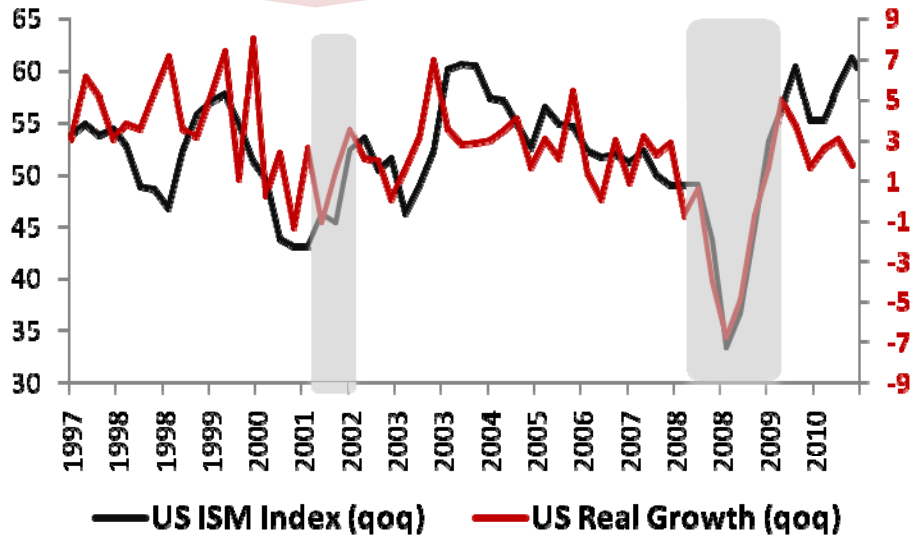
Total construction spending (residential and nonresidential construction spending) continued to decrease due to bad weather conditions in Q1 2011. Also this spending was below its long term trend.

Although the rate of rise in both total and nonresidential construction were at negative levels, the rate of rise began to recover since 2010.

If the recovery in total and nonresidential construction continue, the US growth rate will increase compared to Q1 2011.

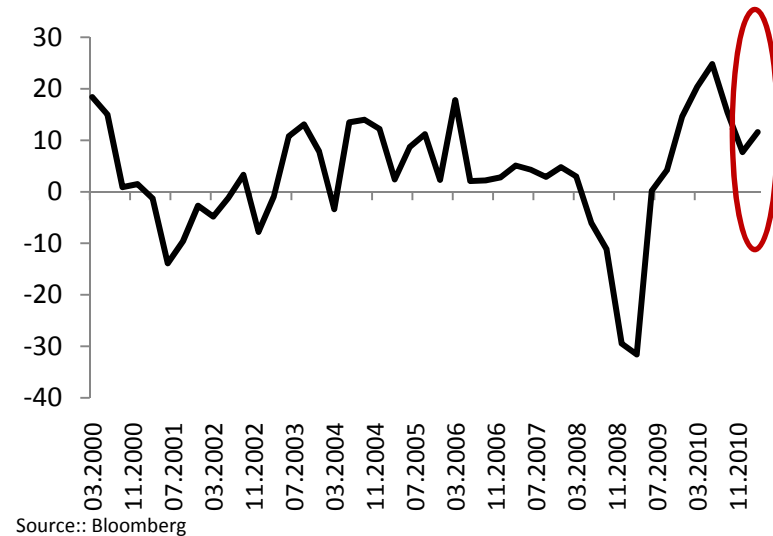
Recent macro economic indicators show that growth may rebound in the Q2 2011...

ISM Manufacturing Index and Growth move parallel to each other. This indicates the close relation between them.



Source, Bloomberg

Equipment & Software Exp. (qoq,%)



- Though the ISM Manufacturing Index declined from 61.2 in March to 60.4 in April, the components in the ISM survey indicated that output trends remained strong.
- Real consumption fell in April due to a strong rise in consumer prices but it is unlikely to be repeated in Q2 2011.
- Decrease in continuing claims signalize ongoing improvement in labor market.
- Despite some volatility in the past months, pending home sales continued upward trend in March.

- Continuing rise in equipment and software investment remains a driving force of the recovery. As boosting investment increase payrolls, it also boost private consumption and thus overall economic growth.

As a conclusion...

- ✎ Unstable housing sector, fragile labor market, reduction of production in Japan and expiration of the second Quantitative Easing Programme (QE2) in June could be the main risks for the US growth.
- ✎ QE2 started in November 2010 and it is set to expire at the end of June 2011 and another QE program is not anticipated.
- ✎ However, the expiration of QE2 before the economy totally recovered has increased the worries about the sustainability of economic growth.
- ✎ It can be said that QE1 and QE2 programmes have supported the US economic recovery by injecting liquidity to markets, however they unlikely to have sufficient effect on the economy.
- ✎ Hence, with the ending of QE2 and without another QE program, the economy would negatively affected. If it was realized FED would take the necessary measures.

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