Let's try blowing into a paper bag

DKW, June 11, 2012

I feel like I have the hiccups as I track the economy. You know the feeling. Everything seems just fine, then all of a sudden you convulse with a diaphragm spasm. Then you wait and wonder when the next one will erupt and when it will all end.

The economy was doing pretty well at the end of 2011. GDP was up 3.0% in the fourth quarter. Industry data was solid and improving. Holiday sales were less than disappointing. Even jobs numbers were showing solid improvement.

Into 2012, all seemed positive. Corporate profits set new records. The unemployment rate was moving steadily lower. The ISM manufacturing and non-manufacturing indices were moving towards the 55 level (above 50 designates expansion). Even job growth had broken out of its mopey state, with U.S. jobs data registering three robust monthly gains: December = 223,000; January = 275,000; and February = 259,000. Private sector job gains were even higher. (Monthly job gains in the 250,000 range are considered sufficient to propel the economy.) Forecasters were raising their rates of economic growth. The Fed had tabled any talk of further quantitative easing, *i.e.,* pumping more money into the economy.

Then, hiccup, March job gains came in at 143,000. First quarter GDP was revised down to 1.9% (hic).

Quarterly profits went higher. Consumer spending went higher. Then April jobs numbers reportedly rose only 77,000 (hic).

Industrial output was rising steadily and was the primary sector driving the economy. Then productivity went negative in May and the manufacturing work week shortened (hic).

Auto sales continued to show healthy gains. Personal income and consumer spending showed real dollar gains in May. Even construction spending increased, including residential single-family investment. Then the May jobs numbers came in at 69,000 (hic). The unemployment rate increased to 8.2% (hic). Factory orders fell (hic). May auto sales dropped 600,000 units to 13.8 million seasonally adjusted annual rate (hic).

The stock market was rallying on the positive economic data. Then the economic numbers softened (hic), the European situation worsened (hic), and China's economy slowed (hic), pushing the stock market to 2012 lows and losses.

Holding our breath

So here we sit holding our breath waiting for the next data to give us another hiccup or allow us a reprieve to breathe more easily.

The current economic situation is one still wrought with uncertainty. The waves of positive then negative data are indicative of an economy not yet on sound footing. Forecasters are holding or dropping their outlook for economic growth rates. Some have even suggested negative growth for a quarter or two in 2012. Quantitative Easing III, or QE III for short, may be back on the Federal Reserve Bank Open Market Committee's agenda. The major players in Europe are working late into the night trying to swaddle Greece, put Italy down for a nap, and bottle feed Spain out of fiscal crises with the suggestive interference of the U.S. and the International Monetary Fund. Another jolting hiccup and the squawking begins again.

There are three major influences affecting the near-term economic outlook, in timeframe order of affects: 1) the ongoing European sovereign financial crises, 2) the presidential campaigns leading up to the November election, and 3) the federal budget “cliff” pending on January 1, 2013.

The Eurozone budget problems have travailed for quite some time. Numerous plans to alleviate the situation have not worked and the situation has now reached a crisis. Greece is now expected to leave the European Union. Italy is preparing for the inevitable. Spain is about to ask for money to bail out its banks. Hic. Whatever the outcome, a new fiscal governance regime will need to be developed for what remains of the zone. Fortunately, the U.S. financial system is pretty well sheltered from that mess. The slow economic growth in Europe, however, is affecting U.S. exports, and Chinese exports. Slower Chinese growth also means slower U.S. growth. Hic.

The rhetoric of the competing presidential campaigns will do little to calm the waters around the economic situation. Confusion and inaction is likely to stall or postpone decisive action to jumpstart economic growth. Hic.

The November election will be quickly followed by our own fiscal mess, the federal budget “cliff” that needs to be addressed in the few short weeks between the election and year end. Tax cut extensions, budget cuts, and the end of unemployment insurance extensions all come due in January 2013. Forecasters say that if no action is taken, the $600 billion decrease in tax revenue coupled with $1.2 trillion in budget cuts will cut four percentage points off GDP growth and push the U.S. into a recession. Hic, hic, hic.

There are many purported cures for the economic hiccups. However, this time around low interest rates haven’t helped. Fiscal stimulus hasn’t helped. Twisting interest rates (selling short-term Treasury Bills and buying long-term Treasury Bonds) hasn’t worked. Home mortgage bailouts didn’t work. Throwing trillions of euros and dollars at continental banks hasn’t worked. Austerity programs in Greece may have made it worse.

Maybe all this will become so frightening that it will scare the singultus right out of us.

The only cure that has worked for me was a shot of lemon juice suggested by a college friend. It was sour going down, but it did the trick.