

## **I Don't Feel So Bad**

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After seeing the words “Answering those questions now is impossible.”, in the June 12, Wall Street Journal about how the economic uncertainty is permeating through the financial markets, I don't feel so bad about the lack of confidence in my outlook.

I have been trying for months now to find a definitive direction and pace for economic growth prospects and what it means for the labor markets. Several times I started to lay out my argument for why the economy will move in a particular direction only to assess the latest data and pull back. Indeed, we have seen continued, if lethargic growth in both the economy and jobs. The economy remains in a suborbital trajectory, posting GDP growth of 1.8% in the first quarter of 2013. This follows a dismal figure of 0.4% for Q4:2012 growth. It is not nearly sufficient growth to lower the unemployment rate. We need growth rate consistently over 3% to dent the unemployment situation.

### **So, why all the indecision?**

*Note: As I was about to publish this piece, the third estimate of GDP was released with revisions bringing Q1:2013 growth down to 1.8% from 2.4%. This doesn't change the outlook substantially as we know the economy is growing at a slow pace. It does raise risks as to the probability of an unanticipated event negatively affecting the upward trend. This is indicative of the volatility of recent data that is affecting the confidence of economic projections.*

The months transpiring since my last entry have been filled with discrete, non-trending data. One month's job gains are up nicely, the next not so much. At the national level, private sector jobs have increased every month since March of 2010. The average job gain for the period is 175,000 per month, but the range has been between 78,000 and 323,000. (We seek about 250,000 new jobs per month to perpetuate economic growth.) The halting nature of the month over month jobs data makes it a bit troublesome to feel strongly about forward momentum.

Industrial production numbers have been a mixed bag also with sub-indexes even more so. Over the last twelve months, the ISM manufacturing index has moved narrowly around the 50 level (50 designating the fulcrum between growth and contraction). Of the twelve months, ten months have been between 49 and 52. This gives nothing to signal a breakout to either side. The primary sub-indexes of employment and new orders also showed an indiscernible trend.

Consumption data has been somewhat more encouraging. Personal income increased over the year by 2.8%. Personal consumption expenditures are up 3.1% year-over-year (y/y). Wage and salary disbursements are up 3.2% y/y. But due to increases in income and payroll taxes, personal disposable income is up only 1.8%. Consumption is outpacing disposable income at the expense of savings (off 31% y/y) and debt reduction. It is yet unclear whether the use of savings and credit for consumption comes from need or want. Nevertheless, it is not a combination that can last long-term. Moreover, without appreciable job gains, aggregate disposable income remains listless and spending limited.

Less government spending at all levels has become the main drag on the economy now. The cutbacks due to the sequester and other programs affect defense and non-defense federal expenditures. Budget struggles have decreased government spending at the state and local levels as well. Total government spending decreased 2.3% y/y, with federal spending down 4.0% and state and local spending down 1.1% y/y. This continues the downward trend begun in 2010.

On the whole, though, I would say things are looking brighter. The reason for my optimism is that the two major sectors showing growth are housing and automobiles. Housing sales and starts are climbing back to reasonable levels. We won't, gladly, see the activity like that of 2004-06, which forced an unsustainable bubble in the market. New home sales are consistently above 400,000 units on a seasonally adjusted annual rate (SAAR). New home sales actually are being held back by the lack of inventory. This is helping push existing home sales over the five million mark SAAR. It has also given a green light to builders, raising housing starts to nearly one million units SAAR. While all these numbers are a far cry from the peaks of the boom, they are better aligned with sustainable demand and continuing upside potential.

New car sales have climbed over 15 million units SAAR. These are levels seen before the recession and the sales levels have been strong for the last seven months. This is a huge recovery from the 2009 levels of around 10 million units SAAR when the auto companies were lining up for bailouts.

These two sectors add substantial muscle to the economic body. Spending on each amounts to three percent of total GDP. The housing and auto industries also have large multipliers. That is to say, the two sectors have long and dense supply chains – they create demand for products in many other industries. For example, when you build a new house, you often get new carpet, drapes, furniture, and appliances. Moreover, the encompassed workforce and product supply are largely local.

There are still substantial risks swirling around all the major economies of the world. Europe is seeing very slow growth at best with most of the majors showing declines. The financial sector in Europe still has a lot of fixing and healing to undertake. China's economy has slowed substantially due to the reigning in of cash and loans by the central government to try to head off speculative housing, investment, stock market bubbles. China's exports have also decreased due to the lack of demand from the major developed countries.

I maintain that the U.S. economy will continue to move higher, but at a slow (< 2.5%) pace through at least the remainder of the year. While decreases in government spending will levy drag, the housing and automotive sectors will keep pushing the economy forward, but not with enough force to significantly affect the employment situation.

In summary, the gyrations in the economic data, Federal Reserve Bank policy innuendo, fiscal debates in Washington, D.C., and on-going global economic angst makes it

difficult to predict with absolute confidence the direction and robustness of the economy's path.

At least I'm not the only one.

### ***What Happened to the Fiscal Cliff***

*We got through the fiscal cliff by rappelling down a level at a time. Some of the Bush tax cuts were ended, primarily increasing the income, capital gains, and dividend tax rates for those making over \$450,000 a year, on January 2, as were the payroll tax cuts. After a two month postponement, sequestration was allowed to kick in. Immediately, both parties sought ways to alter the burdens. The sequester is affecting government spending and is a short-term drag on the economy.*

*In February, the debt ceiling constraint, which would have had the Treasury run out of money in March, was suspended until May 18, giving the Treasury until August to run out of money. So now the debt ceiling debate becomes part of the budget debate.*

*The focus now turns to pointed negotiations on the better budget battle. The Federal fiscal year runs from October through September. Obviously, rhetoric will heat up through the summer as the three-party (President, Republican House, and Democratic Senate) negotiations transpire.*