

# THE ECONOMIC SITUATION

**Bruce Yandle**

*Dean Emeritus,*

*College of Business & Behavioral Science, Clemson University*

*Director, Strom Thurmond Institute Economic Outlook Project*

[yandle@clemson.edu](mailto:yandle@clemson.edu)

We encourage distribution of the report to others. The reports, current and past, are posted at <http://www.strom.clemson.edu/teams/ced/esr.html> To add your name to the report email list or to have it removed, please send an email to Kathy Skinner. She is [kathy@strom.clemson.edu](mailto:kathy@strom.clemson.edu).

**June 2009**

- ❑ **Mr. Obama's Public Sector Stimulus Package**
- ❑ **The Great American Scream Machine**
- ❑ **Translating to GDP Growth**
- ❑ **The 91% Solution**
- ❑ **Reflating a Deflated Economy**
- ❑ **A Golden Age for Entrepreneurs**

## **Mr. Obama's Public Sector Stimulus Package**

Mr. Obama's stimulus package, now working its way into the U.S. economy, is more about stimulating government than the economy. For obvious political reasons, the bulk of the stimulus targets state and local governments and the healthcare sector, two sectors that have weathered the recession rather well. In April, when the nation's overall unemployment rate was 8.9%, the unemployment rate for healthcare and education was 4.5%; for government workers 2.6%. They and mining are the three U.S. sectors that show positive employment growth.

Eventually, of course, there will be significant construction activity generated by the newly inspired government spending. Construction had a March unemployment rate of 18.7%. But the Great Recession of 2007-09 will be over by the time that activity comes on line.

**Understandably, Mr. Obama has campaign promises to keep. The stimulus package is more about presidential politics than energizing the economy.**

Mr. Obama's challenge is seen in Robert Ariail cartoon that follows. For the stimulus to juice the economy, the cables need to connect to the part of the economy that can produce new wealth and employment. That would be the private sector where wealth is actually created. As John C. Calhoun might have put it, we need more "tax payers," not more "tax

spenders.” Unfortunately, the American Recovery and Reinvestment Act contains no cuts for capital gains and corporate income taxes, the stuff that generates new wealth.



(I enjoyed an evening with Ariail recently at Clemson’s Calhoun Lecture Series. He gave me permission to use his work in my newsletters and lectures.)

### **Screaming on the Great American Scream Machine**

To a large extent this Great Recession is like the Great American Scream Machine. As shown below, the recession’s start corresponds to the rollercoaster’s peak. Like the car in the picture, the economy has been falling at an increasingly faster pace..., until recently. Now, it seems, the riders are finally rolling along on an almost flat surface.

Mr. Bernanke says the bottom is near, and my March report said the same thing. When will we get off the recession roller coaster?

All of us can recall that first ride on a truly gigantic roller coaster. With memories of either insane delight or mortal fear, we also remember what it was like to put our feet on terra firma, sometimes with a silent prayer that we would never do it again. But we did.

What matters now are first derivatives. I show a couple of tangents in the figure. When these become perfectly flat, the fall from the top will be over. The recession will have ended.



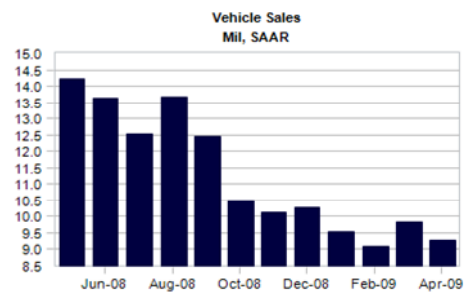
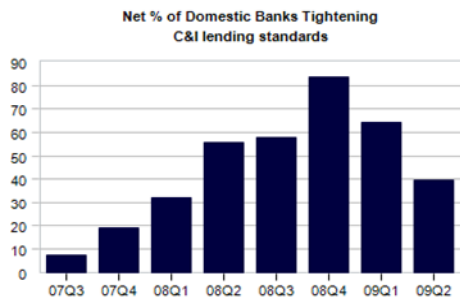
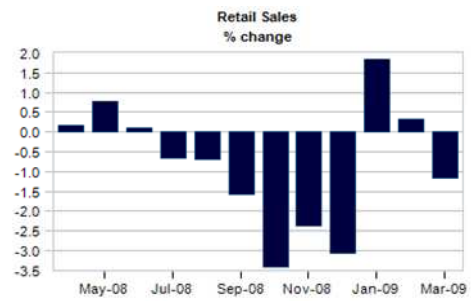
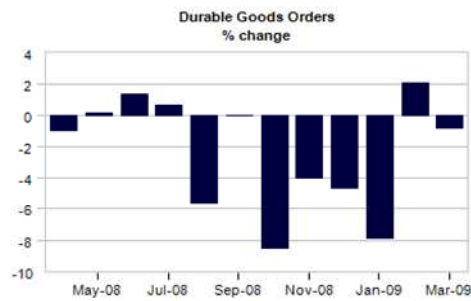
### Taking a look at some indicators.

Meaningful reflections of bottom formation are found in the Institute for Supply Management's (ISM's) production indicators and in data for some other important sectors. The next panel shows the ISM manufacturing and nonmanufacturing (service economy) indexes. Last quarter, we saw a few positive blips. **We see positive trends in both charts. The trend is especially strong for the services economy, which is the larger of the two U.S. sectors. Remember, we are speaking of second derivatives here.** The data tell us that the rate of decline is getting much smaller, but that the roller coaster has still not flattened. That will have occurred when these two ISM indicators reach the magic value of 50.

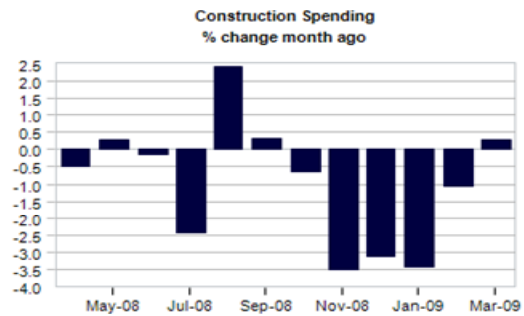
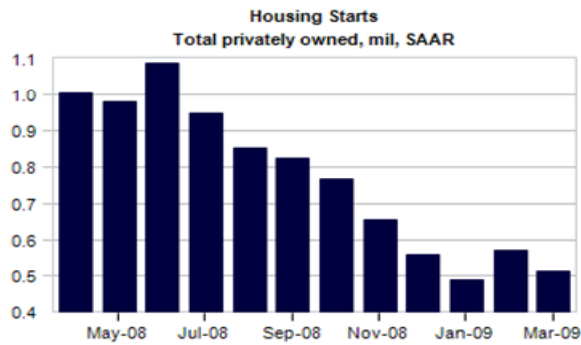
## Two Key U.S. Economic Indicators



The next battery of indicators also contains positive news. Notice first the growth in durable goods orders and retail sales. Both indicators are alternately flashing positive and negative signals, the sort of activity to expect when stability is approaching. **Among the more encouraging data are responses from chief credit officers in the commercial banking sector. Here we see further relaxation of lending standards.** But as indicated in the vehicle sales chart, the relaxed lending has not as yet overcome the uncertainty generated by news of major auto company bankruptcies, dealer closings, and rising unemployment. That small positive upward nudge for vehicle sales in March is like climbing Mt. Everest in the face of an avalanche.

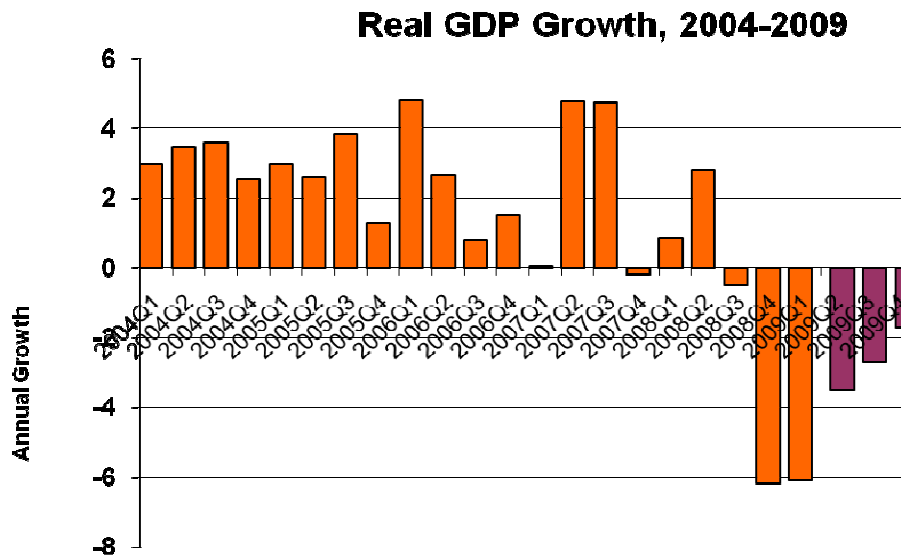


The second panel of data focuses on housing and construction. Here we see a bit of a heartbeat in housing starts and a surprising small uptick in construction activity. The sales data also appear to have formed a bottom.



## Translating it all into GDP Growth

Second derivatives are wonderful for determining whether the fall is slowing or the run up is accelerating, but it is action up and down that is seen when we consider the final tally. The gremlins cheered when the advance reading for 1Q2009 GDP growth arrived in late April. The minus 6.1%, not quite as bad as the 4Q2008 reading, was driven by inventory depletions, a necessary step before speeding up the economic engine. The negative 6.1% was a bit worse than I expected, but still fits the trend I discussed in last quarter's report. The graphed data are shown in the next chart.



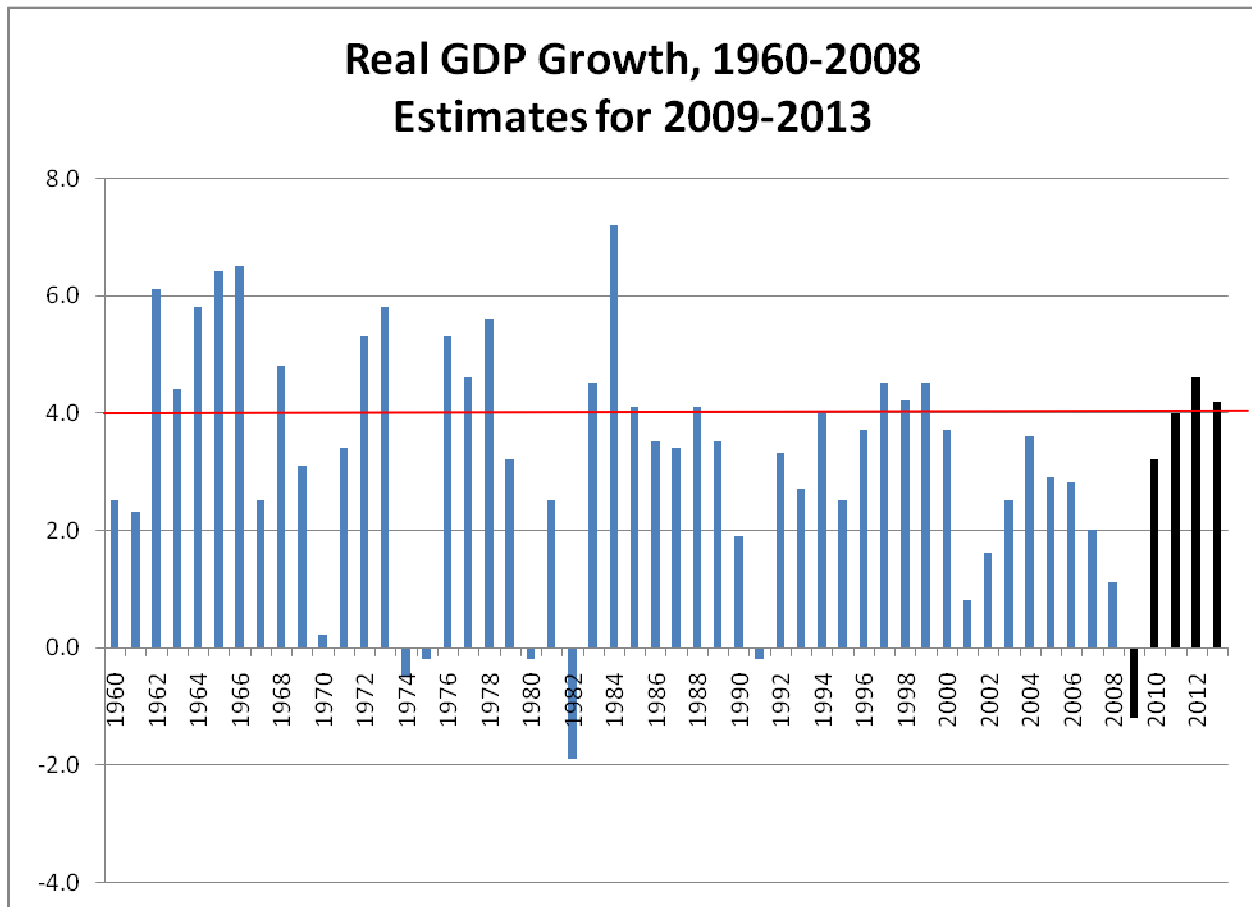
**President Obama is far more optimistic.**

The average growth across the four quarters shown above is minus 3.5%. As shown in the next table, only Wachovia's economists are close to my level of pessimism. The nearer the forecast to the present, the weaker they get..., with one glaring exception. President Obama's forecast calls for minus 1.2% GDP growth. **The President's budget plan for the next fiscal year is based on this optimistic number, which suggests that actual deficits ahead will be far larger than the Obama OMB predicted.**

<b>Forecast</b>	<b>2008</b>	<b>2009</b>
IMF (Oct.)	1.6%	0.1%
Economist.com (Nov.)	1.4%	-0.2%
Economy.com (Nov.)	1.4%	0.0%
Wachovia (Nov.)	1.3%	-1.0%
Economist.com (Dec.)	1.2%	-1.7%
Wachovia (Jan.)	1.2%	-2.3%
Economy.com (Feb.)	1.2%	-1.7%
Economist.com (Feb.)	1.2%	-2.0%
CBO (Feb.)	1.2%	-2.2%
Economist.com (Mar.)	1.2%	-2.7%
Economy.com (Mar.)	1.2%	-3.0%
Obama OMB (Mar.)	1.2%	-1.2%
Wachovia (Mar.)	1.1%	-3.3%
IMF (April)	1.2%	-2.8%

The President's official forecast becomes even more exuberant in the outyears. Over the years 2010-2013, the Obama forecast calls for an average real growth of 4%, a growth rate seen infrequently in recent years. The next chart shows real GDP growth from 1960 to 2008 with the Obama estimates shown for 2009-2013. The 4% average is marked in red.

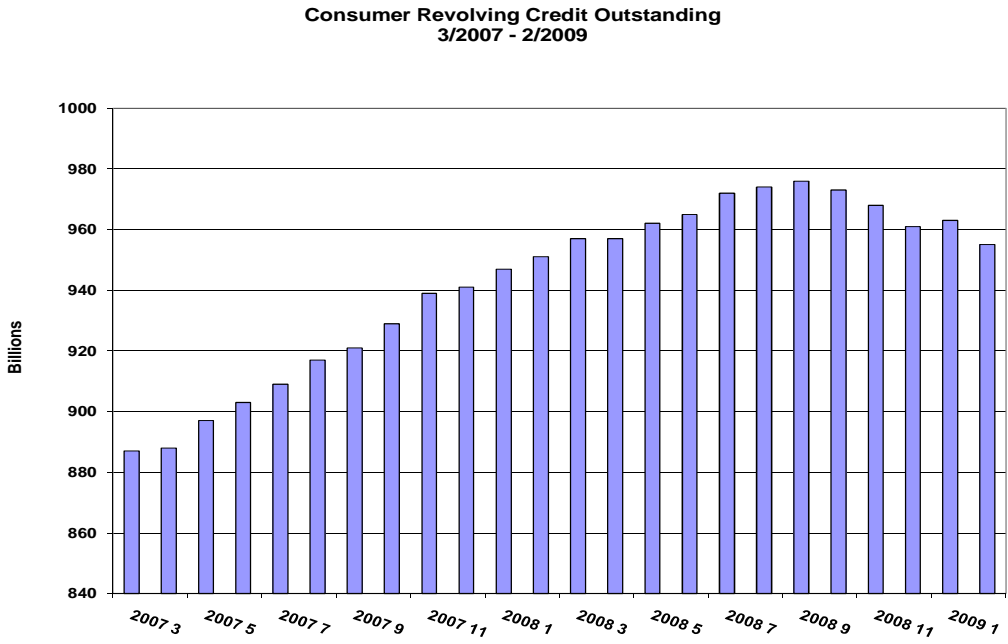




### **Saving and borrowing.**

The rather bleak outlook for 2009 seen by most forecasters is driven by rising unemployment that is translated into reduced consumer spending. Increased saving, the other side of the spending coin, is joined by a reluctance to borrow. The next charts show what has happened recently. The savings level, as shown here, has exploded. In 2007, consumer savings rang up a total of \$50 billion for the year. (Note that this is billion, until recently a rather larger number.) **Consumers are now saving at an annual level of \$500 billion, a ten-fold increase. Lost trust and uncertainty are two of the drivers behind this surge. Rising deficits and expectations of higher future taxes may be a third driver.**

After peaking in September 2008, consumer borrowing, not including mortgage debt, is headed south. We should expect to see some relaxation in savings as GDP growth bottoms and turns positive in the year ahead. With rising employment, we should expect to see recovery in consumer borrowing.

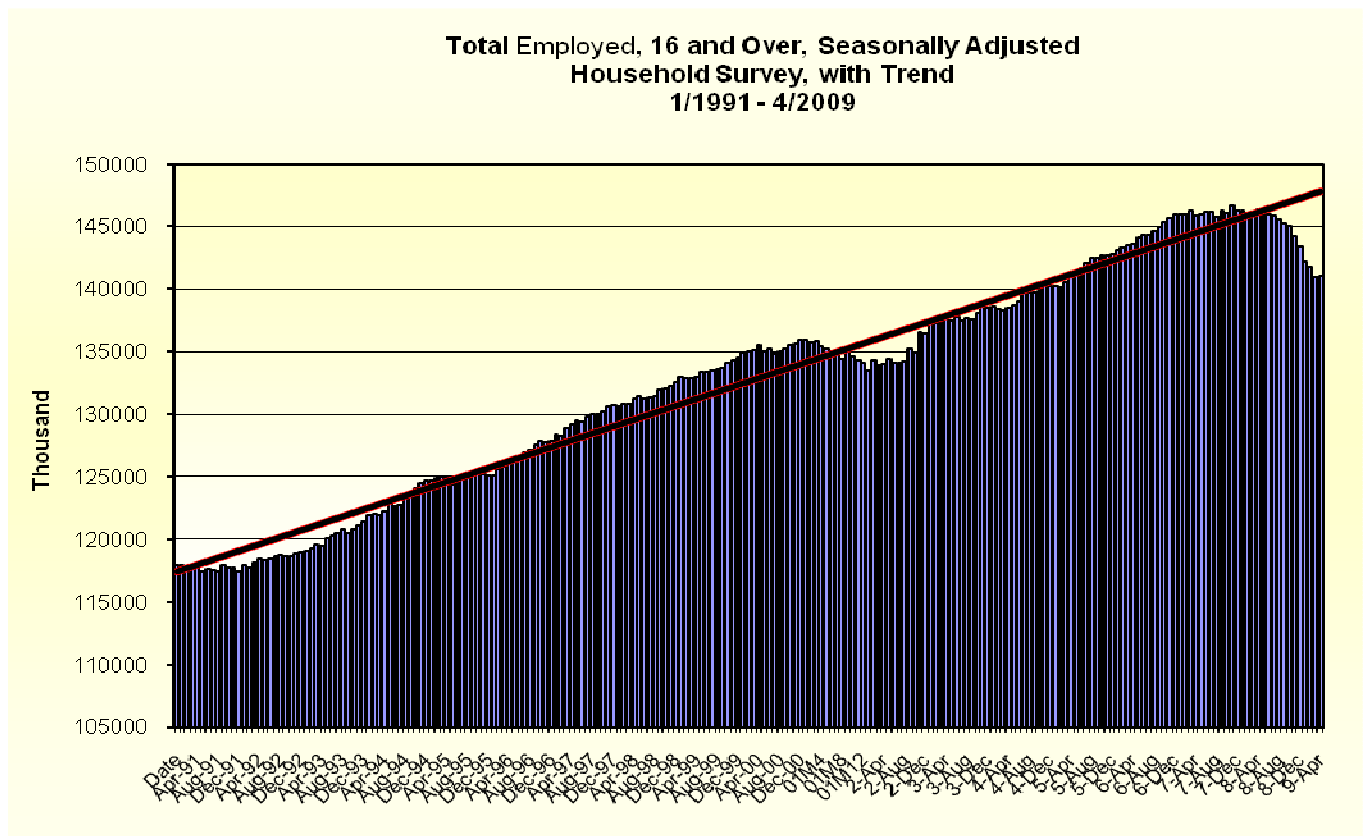


## The 91% Solution

April's unemployment rate of 8.9% tells us that about 91% of those seeking work are still able to find jobs. Yes, this does not account for the discouraged workers who decided to drop out of the market, but it does include the new entrants to the labor market, those who have hit a point or place in their lives where work is the logical choice for them. While an 8.9% unemployment rate generates misery for a huge number of people, the 91% employment rate generates a massive amount of output for all to consume.

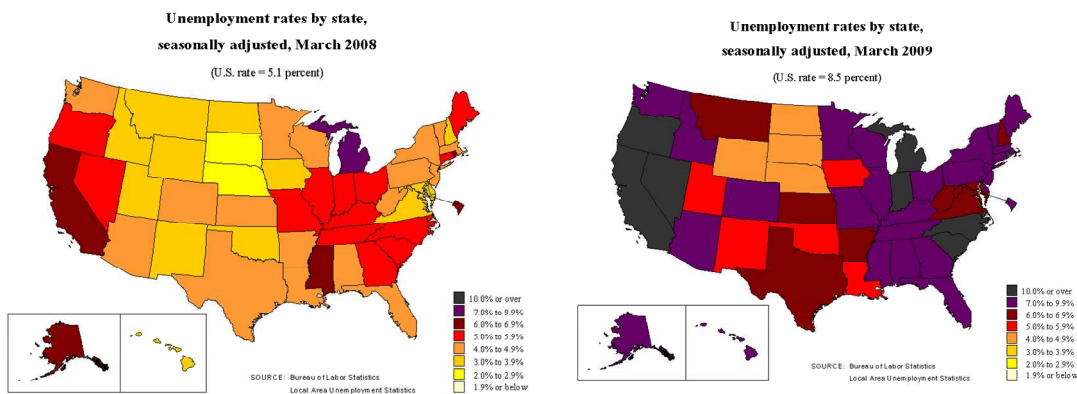
**It is a weak but still chugging American Bread Machine that will slowly pull us out of the Great Recession.**

The data in the next chart show employment based on the Bureau of Labor Statistics monthly household survey. A close look at the last few months tells us that gap between trend and level is large. **But if you take out a magnifying glass to examine the chart, you will see that the April employment level actually went up!** Yes, the unemployment rate also went up, which means that the size of the labor force—those looking for work—increased. The shape and magnitude of the gap suggest that it will be a long time before trend-level employment is achieved again. Indeed, we might see the gap close near the beginning of 2011.

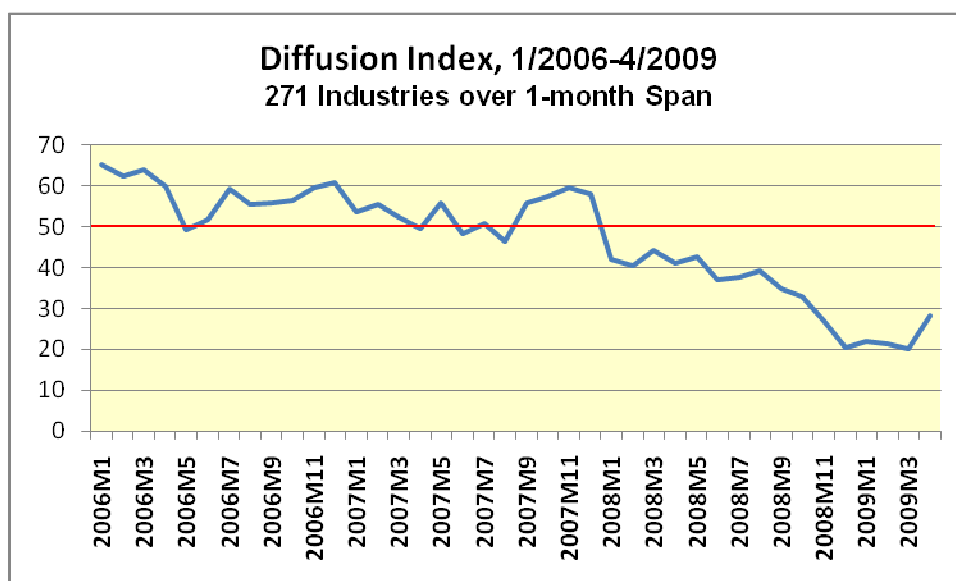


While the employment gap is wide and deep, the geographic unemployment pattern has also continued to spread. The next two maps give a comparison of March 2008 and 2009.

### U.S. Recession Contagion March 2008 to March 2009



Along with total employment, there is another labor market indicator that sends a positive signal. The diffusion index for unemployment measures the extent to which employment is expanding across 271 U.S. industries. **As indicated in the next chart, the diffusion index is pointing north. Here is yet one more sign that the economy may be near the end of the sliding board.** Remember, 50 is the magic number that identifies a kind of neutral point where the number of expanding industries just equals the number contracting.



## Reflating a Deflated Economy

The March Bureau of Labor Statistics report on CPI inflation contained some unusual news:

“The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.2 percent in March, before seasonal adjustment, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. **The index has decreased 0.4 percent over the last year, the first 12 month decline since August 1955.**”

Now, I remember August 1955. That was the summer after I graduated from college. I remember getting a commission and heading off to the Army, but I don't remember that deflation was playing through the economy at the time.

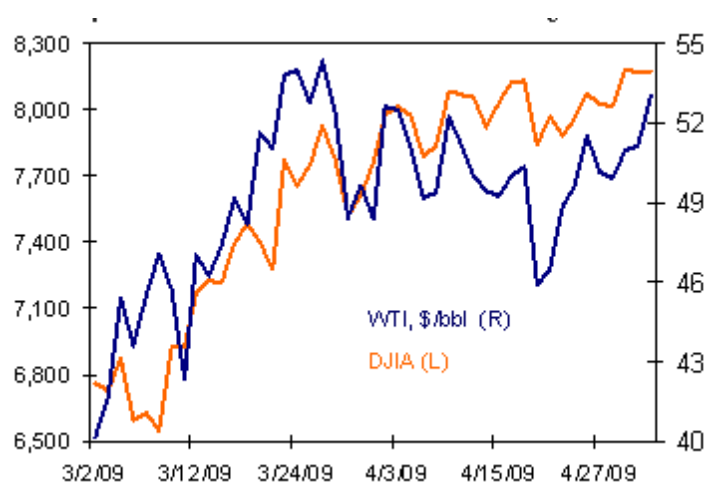
That was then. This is now.

In my running commentary on this Great Recession, I have regularly noted that deflation is a major economic force in the economy and that future inflation is the major risk we face from efforts to counter the deflation. The problem is all about printing money and stoking credit markets in an effort to offset the credit market collapse.

As indicated in the CPI report noted above, efforts to counter inflation have not been successful..., if the word successful is appropriate here. Deflation is the dominant force..., for now.

There is one relationship noted by Economy.com that seems to suggest otherwise. I provide here that organization's chart that maps the Dow-Jones Industrial Average into the

price of crude oil. As indicated, recently rising oil prices—with the promise of future inflation, perhaps—map nicely into the DJIA increases. Is the Dow a hedge against inflation or what? We know that correlation is not causation, but here are some possibilities to consider: 1) Yes, a reflated economy shows itself in the Dow, 2) Higher priced oil reflects a recovering world economy, which is also reflected in the Dow, and 3) oil company stocks in the Dow and are boosted by rising prices.



### Final Thoughts: A Golden Age for Entrepreneurs

The mid-year economy shows multiple signs of reaching the bottom of the Great Recession. Saying that a bottom is found does not say that recovery is underway. All indicators surveyed in this report suggest that the start of recovery is several months out, perhaps as far away as early 2010.

The impact of the various policy actions taken in the name of stabilizing financial markets and stimulating the economy are targeting large firms, those called too big to fail, state and county government activities, and the healthcare sector. Along with bundles of assistance come additional constraints. Those sectors receiving the most assistance will become less agile. While members of the palace guard, they will form a new economic sector, one that has stiff joints, hardening of the arteries, and less ability to respond quickly to opportunity. Those unblessed firms and organizations that are small enough to fail will gain. They will be relatively more active and competitive.

In short, the American Recovery and Reinvestment Act provides immense opportunity for entrepreneurs to move forward.

We can measure the pace of entrepreneurship in the economy by examining data on what the Bureau of Labor Statistics calls “nonemployer firms.” These are employer firms with no employees, another way of saying they have one person working. About 75% of all U.S. firms fall into this category. Many of these are in the business consulting and services sector. They form part of the knowledge and nervous system of the economy. They can also be thought of as marker species that indicate entrepreneurial opportunity.

**When large layoffs occur and major financial firms experience shutdown, large numbers of bright, experienced people take the opportunity to start a small, highly specialized firm. These firms then band together to take on larger projects. They stimulate the economy.**

The data in this last chart show the annual change in the number of nonemployer firms compared with real GDP growth. As noted, the number of new firms expands during times of slower growth.

**We have another wave of entrepreneurship in the making. Pass the word.**

