

June 2011

Introduction

At the beginning of 2011, the coming year promised to be one of growth, recovery, and progress. Now nearly half way through 2011, the U.S. economy has fallen far short of these expectations and instead a second recession is threatening the already fragile U.S. economic system. While a strong May savings rate, easing oil and gas prices, strong May light vehicle sales, and generally healthy corporate balance sheets provide us with hope of a strengthening economy, the majority of economic data paints a very pessimistic picture for the coming months. The reported 1.9% U.S. GDP growth in the 1st Quarter of 2011 is actually only .7%, as two-thirds of said growth is currently being held in inventory that has not been sold. Therefore, adjusted growth for the 1st Quarter of 2011, discounting for inventory, is a meager .25%. Gold and silver prices have been heralding the arrival of higher inflation and in May U.S. inflation jumped to 3.6%, which is its highest level since October 2008. With deficit negotiations in Washington at a near standstill, the August 2nd deadline for raising the debt ceiling seems to be approaching faster than effort to resolve it. Failure to take action would deal the U.S. economy a severe blow, with the consequences of said blow rippling across the globe. Equally as concerning is the current European debt crisis that likewise threatens global implications.

Key May/June Data

Positive Signs

U.S. productivity remains among the highest in the world while U.S. non-financial corporations' cash reserves remain at nearly \$2 trillion dollars. The May Conference Board Global Leading Economic Indicators Report shows

Europe and China as positive at .4% and .2% respectively, while the U.S. was down .8%. The U.S. savings rate remained strong at a notable 5.0% in May. Automobile, SUV, and light truck sales were healthy again in May. Nearly 3.5 million units have been sold during March, April, and May which is the largest three month cumulative level since the end of the Cash for Clunkers program in 2008. The U.S. dollar index increased 3.5% in May and is up roughly .5% in June. While housing starts are still very low, the index did increase to 55.6 in May which is its highest level since August 2010. After dropping 11.6% in April the pending home sales index rebounded in May, increasing 8.2%. Durable goods orders and shipments both rebounded in May increasing by 2.9% and .4% respectively, compared to May 2010.

Negative Signs

The Dow Jones Industrial Average has been on a steady decline since the beginning of May, dropping 619 points (4.8%). According to the latest manufacturing ISM Report on Business, the Manufacturing index of the U.S. economy fell to 53.5, breaking its streak of four consecutive months of being over 60.0. This is also its lowest value since September 2009. The unemployment rate was unchanged in May at 9.1%. President Obama's call for job-creation stimulus only promises to worsen the ongoing debt crisis. The U.S. remains one of the highest corporate tax rate countries in the world at an average rate of 39.27% with U.S. companies holding more than \$1.2 trillion overseas as a result. Rumors of tax hikes to combat the ballooning national debt only create a bleaker outlook for the United States. Consumer Confidence fell 5.2 points in May down to 60.8, which is a six month low. Construction spending remained at rock-bottom levels in

April, down nearly 10% from April 2010. While gold, oil, and silver prices have eased recently, the possibility of a global inflationary cycle is still very real.

Current Issues

A recession is generally defined as two consecutive quarters of negative Gross Domestic Product (GDP). Generally speaking, a double dip recession is a recession followed by a short period of economic growth and then another recession. The technical definition of a double dip recession specifies that a short period of economic growth is signified by two quarters of positive growth of GDP, although economists argue over this exact definition. Double dip recessions are damaging to the morale of an economy as evidenced by a lack of substantial recovery and a failure to return to long run economic confidence. Since the U.S. economy has been in an erratic and slow recovery since early 2009, a return to a recession, which many economists have been talking of as of late, would more correctly be referred to as “back-to-back recessions” rather than a double dip recession.

Current economic data is mixed at best, and many economists are seriously entertaining the idea of another recession. Just .25% adjusted growth in 1st quarter GDP coupled with the uncertainty over the European debt crisis, the more than \$14.4 trillion U.S. national debt, the possibility of increases in U.S. personal and corporate tax rates and concern over regulations and the implementation of health care reform all paint a rather pessimistic picture for the coming months.

While the threats of a second recession are very real, they are not ordained. In order to avoid this severe economic downturn, the United States must get its fiscal house in order. The U.S. national debt is closing in on 100% of GDP, and this trend must be stopped and reversed. Members of Congress must have the courage to cut

government spending and not attempt a quick fix by increasing taxes. A tax increase in our opinion will only slow or break the back of an already tenuous U.S. economy. It is time that members of Congress make the same types of spending cuts and difficult decisions with the federal budget that households and businesses have been making over the last three years. Restructuring government and making it more efficient is the answer, not the encouragement of more of the same. We believe that cutting the corporate and personal tax rates in the United States would spur economic growth and increase tax revenue to the federal government. One needs only to study President Kennedy’s tax cuts of the 1960s and President Reagan’s tax cuts of the 1980s to see that this is true.

Conclusions

The shock of a second recession to American businesses and households would be profound and devastating. The time is right for political leaders to step forward and lead the charge in restructuring the U.S. government into a leaner, more efficient and certainly more frugal machine. For all our sakes, let’s hope this is not too much to ask for.

Contact Us

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