

November 2011

Introduction

As we draw to the end of 2011 the economy is showing mixed and taxing results. The year has been trying for consumers and businesses alike and has been a roller coaster at best for investors. This year was to be a time of growth and recovery, yet it is proving to be a time of great uncertainty and confusion. As we reported last month, the economy is signaling very slow growth to a recession and continues to remind us of the stagflation that plagued the U.S. economy late 1979-81, only with global implications. U.S. GDP growth for the year is averaging less than 2 percent and inflation continues to hover above 3.5 percent. Gold and silver prices are down with gold below \$1,700 an ounce and silver below \$32 an ounce. The U.S. "Super Committee" failed to cut \$1.2 trillion from the federal budget over the next 10 years leaving automatic cuts to be made in defense and other areas.

Key October/November 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. The November Conference Board Global Leading Economic Indicators Report shows the U.S. and China increased at .9 percent and .4 percent respectively, while Europe decreased by .7 percent. The U.S. savings rate settled at 3.5 percent in October, down from 4.5 percent in September. The savings rate continues to slide and is down nearly 2 percent from July. Although automobile, SUV and light truck sales were down 3.1 percent in October relative to September 2011, they were up 6.5 percent relative to October 2010.

Monthly total light vehicles sales have exceeded one million units for the last eight months. Personal disposable income was up 3.1 percent relative to October 2010 and now sits at \$970 billion. While the pending home sales index fell 4 percent in October relative to September, the October 2011 level is still higher than the October 2010 level. The Dow Jones Industrial average finished October up 1,300 which reversed a two and a half month slide. The Dow declined in November but rallied at month's end.

Negative Signs

The unemployment rate remained high but down slightly to 9 percent in October as nonfarm payroll employment increased by 80,000 and private sector employment increase by 110,000. Despite President Obama's job-creation focus, all progress seems to be eluding him. The U.S. remains one of the highest corporate tax rate countries in the world at an average rate of 39.27 percent with U.S. companies holding more than \$1.3 trillion overseas as a result. Oil prices have climbed in November, surpassing \$99 a barrel. Likewise, gold and silver prices reversed their downward slide and have begun to settle at just under \$1,700 and \$32 per ounce, respectively. According to the latest manufacturing ISM Report on Business, the Manufacturing sector of the U.S. economy decreased to 50.8 in October from 51.6 in September, but is still very close to falling below 50 which signals trouble in the manufacturing sector. Housing sales slide for the third straight month in October. Consumer Confidence dropped considerably in October, reaching its lowest level since March 2009. The dollar index is also down about 4 percent for October.

Current Issues

Average European Union public debt is just over 80% of GDP with average total national debt greater than 110% of GDP while U.S. debt is roughly 68% and 97% respectively, with Japan's national debt to GDP ratio at roughly 200%.

Governments globally finance operations largely via three tools: a) taxation, b) borrowing and c) inflation of their currency. The global financial crisis we have today is due to the fact that governments cannot or choose not to balance their budgets. Financial markets are nervous due to what higher taxes will mean to economic recovery while the credit markets are not confident in loaning more money to many European countries and less confident in the U.S. today. The worry is that a credit collapse will result in either a) recession or b) monetary inflation and global stagflation. Thus, there is no room to use the above tools without large cuts in government spending...global markets want to see politicians get their financial houses in order which simply means less government spending and balanced budgets...this will not be easy...nor without difficult choices for programs ranging from government pensions and social welfare to defense. Europe is the largest trading partner for the U.S. and a recession in Europe would significantly harm U.S. exports and domestic jobs.

The current crisis is greatest in Europe with the following problems looming.

1. European policymakers cannot convince investors in their debt that they can or will resolve the European crisis with the tools above and spending cuts.
2. Increasing interest rates on European debt instruments is needed to sell said debt. The higher rates are driving up the cost of financing government and slowing down the economy which reduces tax revenue.

3. Many European countries like Greece and Spain are arguing for a return to their local currencies so they can use inflation to finance their debts.

4. Many in Europe are pressuring the European Central Bank (ECB) to monetize the debt of countries like Italy, Portugal, Spain, Greece and others which could lead to high inflation and eventually even higher interest rates.

5. If the European Union does not come to an agreement on reducing the size and scope of government largely by cutting spending, the future of the Euro and the EU is in jeopardy.

Conclusions

The United States is less than 10 years behind facing the troubles Europe confronts today...a collapse of the U.S. economy is not out of the question.

Contact Us

Comments or questions should be directed to Dr. Timothy G. Nash at: tgnash@northwood.edu or (989) 837-4323.

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