Northwood University's
Monthly Economic Outlook

April 21, 2011

Introduction

March and early April data show the U.S. economy moving in a positive yet tenuous direction. The third revision of 4th quarter U.S. GDP for 2010 remained at a solid 3.1% growth rate. We are deeply concerned over oil prices, the Japanese economy (especially automobile parts production) and the current unrest in the Middle East and Northern Africa. The negative impact that a shortage of Japanese automobile parts and gasoline prices just north of $4 a gallon nationally will have on automobile sales, travel and tourism harkens back to the conditions we faced in the summer of 2008. We grow more and more uneasy over the increasing size and scope of the U.S. national debt which will reach the U.S. debt ceiling of $14.3 trillion dollars by early May 2011. The White House and Congress do not seem capable of bi-partisan cooperation and true debt reform. Recent quantitative easing by the U.S. Federal Reserve Bank (FED) coupled with record deficits have triggered ever-growing inflation rates in the U.S. and globally and a loss of confidence in the dollar as the world's reserve currency. U.S. inflation was up 2.7% from March 2010 to March 2011 with unadjusted March 2011 inflation reaching 6% on an annualized basis. Annualized inflation in China is 5% so far in 2011 versus 3.5% in 2010, while the Euro has topped 3.1% in March of 2011 relative to a 2.0% inflation rate in 2010. Oil surpassing $112 on the NYMEX in early April, U.S. wholesale prices up 5.8% versus March 2010, gold breaking through $1,500 an ounce and silver approaching $50 an ounce are all strong signals that a global inflationary cycle is likely upon us.

Key February/March/April Data

Positive Signs

According to the latest manufacturing ISM Report on Business, the Manufacturing sector of the U.S. economy was still strong at 61.2% even though it realized a slight decline of .2% in March. 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 Dow Jones Industrial Average rose 262 in March or an increase of 1.2%. The March Conference Board Global Leading Economic Indicators Report show the U.S., Europe and China all positive at .8%, .9% and .3% respectively. The U.S. savings rate continued at an impressive 5.8% in March. Automobile, SUV and light truck sales were up in March versus February 2011 and more than 16% vs. March 3010. The U.S. unemployment rate dropped to 8.8% in March from 8.9% in February, with more than 201,000 private sector jobs being created in March. The U.S. Pending Homes Sales Index increased 2.1% in March.

Negative Signs

While the national unemployment rate fell by .1% in March, it is still at a sobering 8.8%. February and March inflation rates are on the rise with wholesale prices signaling increased inflation for the future. The average 30-year fixed mortgage rose to 4.9% from 4.86% in February—a likely sign of increasing inflation. While gold, silver and oil prices seem to be confirming inflationary problems and our concern over global economic stability. Unemployment benefits remain at record highs and will continue at these levels for the next

12 months. The dollar was down against the Euro in March. 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.

Current Issues

Historically, sound money has had many characteristics or attributes. Money is a medium of exchange for complex trade—something that others have faith in and will readily accept. It is a unit of account and that allows prices and values to be compared and accounted for in readily understood terms. It is a liquid asset and can be converted to purchase goods and services. Over time money's most important attribute is that it is supposed to be a store of value and will hold its purchasing power over time! For decades during the 1800s the price of items from tobacco and cotton to wheat and iron stayed constant because money was a store of value under a bi-metallic U.S. monetary system of gold and silver. A recent conversation with my father gave me pause to question U.S. monetary policy in his lifetime and the concern we face regarding U.S. and global inflation. My 86-year old dad recently recalled that in 1940 the Cleveland Plain Dealer Newspaper was $.03 for the daily and $.10 for the Sunday edition, an adult ticket for a double feature movie at the local cinema was $.25, a double scoop ice cream cone was $.05, hamburger was $.15 a pound, bread was $.08 a loaf and a Baby Ruth candy bar was $.05 or three for $.10.

Standard Oil founder John D. Rockefeller died in 1937 and had amassed a fortune of $1.4 billion [1.53% of 1937 U.S. GDP] at his passing. Forbes Magazine contends that after adjusting Mr. Rockefeller's fortune for inflation and economic growth, he would have been worth as much as $663 billion in 2007 inflation adjusted dollars.

Based on the U.S. Consumer Price Index, the 2010 U.S. dollar purchases roughly 1/15 of what a 1940 dollar purchased or it would take just over $1,500 in 2010 to purchase what $100 purchased in 1940.

Inflation is a cruel tax and is caused by improper monetary policy on the part of a nation's central bank. Inflation should not be confused with short-term price increases based on changing supply and demand conditions for a given good or service. The dollar as a store of value for the world is coming into question today as a result of FED quantitative easing and our growing national debt.

Conclusions

Upon further reflection, it is important to understand that we are at an economic and political crossroad in this country. For decades, many Americans have watched as their wages have increased at a rate below the rate of inflation or not at all. All too often government has paid for programs not by deficit spending (borrowing) or tax revenue, but rather by creating inflationary dollars to pay for programs thus devaluing the purchasing power of the dollar and thereby reducing standards of living in this country. I wonder what I will tell my children or grandchildren about prices in 2012? How about you?

Contact Us

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