

Northwood University's Monthly Economic Outlook

July 2011

Introduction

At the end of the 2010 it appeared that the U.S. economy, though it had taken a beating, was licking its wounds and getting back up on the proverbial horse. Now seven months later we find ourselves bucked from that horse again as current economic data shows signs that the U.S. economy may again be slowing down and in fact may be nearing a second recession. The "final estimate" of U.S. GDP for the 1st Quarter of 2011 was downgraded dramatically to .04 percent growth with initial 2nd quarter 2011 GDP registering a meager 1.3 percent. While June inflation remained unchanged at 3.6 percent, soaring gold and silver prices continue to threaten the arrival of higher inflation. The debt crisis weighs even more heavily on our minds as the August 2nd deadline for raising the deadline looms closer. Failure to take action would deal the U.S. economy a severe blow, with the consequences of said blow rippling across the globe. America is now at a crossroads and the decisions made today will reap consequences for years, even decades to come. Only by concerning ourselves with the economic data, the facts of the case, can American have a more logical and less risky approach to solving her woes.

Key June/July 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 June Conference Board Global Leading Economic Indicators Report shows the U.S. and China as positive at .3 percent and .5 percent respectively, while Europe was down .2 percent. The U.S. savings rate remained strong at a notable 5.0 percent in June. Automobile, SUV and light truck sales fell roughly

.7 percent relative to May 2011, but were up more than 7 percent relative to June 2010. Over 4.5 million units have been sold during March, April, May and June which is the largest four month cumulative level since the end of the Cash for Clunkers program in 2008. According to the latest manufacturing ISM Report on Business, the Manufacturing sector of the U.S. economy rose to 55.3, breaking its four month slide and hopefully starting a new upward trend. Housing starts continued its rebounding trend that began in May by increasing even further to 62.9 in June. This current level is 86 percent higher than the end of 2010 as well as the highest level since October 2008. The pending home sales index rose again in June, increasing 2.4 percent to 90.9, an increase of 19.8 percent from the June 2010 level which was a low following the expiration of the home buyer tax credit.

Negative Signs

The Dow Jones Industrial Average increased 124 points in June (1 percent) but through July has fallen 282 points (2.2 percent). The unemployment rate settled at 9.2 percent in June as nonfarm payroll employment increased by just 18,000. President Obama's call for job-creation stimulus dollars 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 percent with U.S. companies holding more than \$1.2 trillion overseas as a result. Consumer Confidence fell further in June, down to 58.5 which is a seven month low. Construction spending remained at rock-bottom levels in May, down nearly 8.5 percent from May 2010. While gas and oil prices have eased slightly over the last couple months, the threat of a global inflationary period is still very real. While June durable goods orders and shipments rebounded from a poor May performance, there was little change relative to June 2010.

Current Issues

We ask our president and congress to carefully consider and debate the proper role and size of government in light of the concerns voiced over America's "Debt Crisis" and the strain on today's economy. We also hope the following suggestions will resonate as possible solutions.

1. Create a bi-partisan commission to investigate the reform of our federal corporate and individual tax systems and report back to the American people in one year. Strong consideration of a "fair tax," "flat tax" or a narrow tax range based on the research of growth-friendly economists like Arthur Laffer should be made. Countries such as Switzerland and Hungary seem to have had great success recently with low rate, more incentive-based tax systems. Tax reform must encourage job creation, savings and investment and not drive business overseas. We believe consideration of the "fair tax proposal" or a flat corporate income tax rate of no more than 20 percent, eliminating most exemptions and deductions, is a good place to start.

2. Create a bi-partisan commission to investigate a federal "Balanced Budget Amendment." As of 2002, forty nine states (excluding Vermont) have balanced budget requirements, most of which are written into their constitutions. Over the years, the total combined expenditure made by all fifty states annually is just under 50 percent of federal spending annually. Yet, the cumulative total of state debt realized over the same period is roughly one-tenth of the U.S. national debt indicating that mandated budget constraints seem to work. This task will not be easy considering that almost 60 percent of federal government spending today is mandatory in comparison to 27 percent in the mid-60s.

3. Create a bi-partisan commission that would study the opportunity to reduce the size, scope and cost of government by considering the privatization of programs

such as social security, VA Hospital Administration, maintaining and building roads and even space exploration. Many countries such as Germany, Chile, Mexico and Japan are experimenting with privatization with great success. Data also indicates regulatory reform is needed to enhance American competitiveness around the world.

4. The United States needs to adopt a rational, market-driven monetary policy, not one beholden to the whims of the political process and the devastation of inflation.
5. More than 29 percent of all land in the United States is owned by the federal government. If a constitutional constraint on government spending were adopted it should force an end to the out of control government spending of the last thirty years. Then the federal government could consider the sale of some land and mineral rights to raise dollars to retire a significant portion of our national debt once and for all.

Conclusions

Perhaps we can all take a little extra time after reading the above and send this it to our members of Congress.

Contact Us

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