Northwood University's
Monthly Economic Outlook

August 2011

Introduction

Despite the high hopes for 2011, this year has proved to be a very trying time for American consumers and investors alike. A year that was supposed be a time of growth and recovery has turned out to be anything but, and current economic data shows signs that the U.S. economy may again be slowing down and is even threatening a second recession. In the Bureau of Economic Analysis's most recent release they announced a revised estimate of U.S. GDP for the 2nd Quarter of meager 1.0 percent. Additionally, 1st Quarter GDP was downwardly revised from 1.9 percent to just .4 percent. While July inflation again remained unchanged at 3.6 percent, soaring gold and silver prices continue to threaten the arrival of higher inflation. The August 2nd deadline to raise the debt limit came and went and with only hours to spare President Obama and Congressmen arrived at a "solution" to this mess which cut spending minimally and gave Congress $400 billion in additional spending power and also promised to cut spending by $1 trillion over the next decade. However, many critics warned that this compromise was too mild, and they proved to be right. Days after President Obama signed the "debt deal" Standard and Poor's downgraded the U.S. credit rating, stripping the U.S. government of their prestigious AAA rating. Uncertainty has ruled the market since as investors are unsure of the near future for the U.S. economic system.

Key July/August 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 .5 percent and 1.0 percent respectively, while Europe was down .3 percent. The U.S. savings rate remained high at 5.4 percent in July, which is its highest level since September 2010. Automobile, SUV and light truck sales were up in July relative to both June 2011 and July 2010. Over 5.5 million units have been sold during March, April, May, June and July which is the largest five month cumulative level since the end of the Cash for Clunkers program in 2008. After a two month slide, Consumer Confidence rebounded in July, increasing to 59.5 from a revised 57.6 in June and fell dramatically in August. Average disposable income increased even further in June to $966.1. This marks the ninth consecutive month that disposable income has increased. Construction spending also increased in June for the fifth straight month, and is now 16 percent higher than its January level. The pending home sales index rose 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. Durable goods orders and shipments soared in June, reaching its highest cumulative level since September 2010.

Negative Signs

The Dow Jones Industrial Average fell 440 points in July (3.5 percent) and through August has fallen over 800 points (7.9 percent) erasing all gains made this far in 2011 and then some. The unemployment rate settled at 9.1 percent in July as nonfarm payroll employment increased by 117,000. 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 $1.2 trillion overseas as a result. While gas and oil prices have eased slightly over the last couple months, the threat of a global inflationary period is still very real. Silver eclipsed $40 an ounce and although gold is currently trading around $1,760 an ounce, it reached over $1,900 an ounce earlier in August. According to the latest manufacturing ISM Report on Business, the Manufacturing sector of the U.S. economy fell to 50.9, continuing its downward trend that was momentarily broken last month. Housing starts discontinued its upward trend that began in May by falling from 60.1 in June to 56.3 in July.

Current Issues

Economic freedom is the right of every individual; that is the right to control one's own property and labor and use it in whatever manner seems best, provided that the liberty of others is not encroached upon when doing so. The Heritage Foundation and the *Wall Street Journal* describe an economically free society as follows: "In an economically free society, individuals are free to work, produce, consume, and invest in any way they please, with that freedom both protected by the state and unconstrained by the state. In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself."

As an essential for achieving prosperity and a higher standard of living, tracking economic freedom is of the utmost interest and value. The Heritage Foundation and the *Wall Street Journal* have achieved this through their Index of Economic Freedom which calculates a numeric value for economic freedom where a higher value equals a more free society. To calculate this number the following ten components are considered: business freedom, trade freedom, fiscal freedom, government spending, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption and labor freedom.

The U.S. has long been heralded as the "land of the free" and in 1995 was ranked fourth in the world in economic freedom. Since then, however, the U.S. has steadily fallen in the rankings and in the most recent 2011 index the U.S. settled in the ninth position.

Very similar to the Heritage/WSJ Economic Freedom Index, the CATO/Fraser Economic Freedom of the World Index aims to calculate a numeric value for economic freedom with the intention of shedding light on the connection between economic freedom and prosperity. With the belief that the cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete and security of privately owned property, this index calculates economic freedom by assessing the following areas of each country: size of government – expenditures, taxes and enterprises; legal structure and security of property rights; access to sound money; freedom to trade internationally; and regulations of credit, labor and business.

This index confirms the conclusion drawn from the Heritage/WSJ index: from a comparative standpoint the U.S. has become less economically free over the last two decades. According to the CATO/Fraser Economic Freedom of the World Index, the U.S. ranked third in the world in 1990 and 2000. However, in the most recent index, 2010, the U.S. fell to sixth in the world while economies like Hong King and Singapore continue to lead the way in promoting economic freedom and more robust economic growth.

Conclusions

In addition to our $14.6 trillion U.S. national debt, Congress must get a handle on and reduce the burden of regulatory costs facing the United States as well.

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