Northwood University's
Monthly Economic Outlook

November 10, 2010

Introduction

The United States economy continues to try to shake off one of the most challenging economies in its history. By many standards, 2009 was the worst year since the Great Depression. Annual U.S. Gross Domestic Product (GDP) declined 2.4 percent, while Global GDP declined by 2 percent. Currently, the U.S. economy is showing mixed signs of improvement and still faces daunting financial issues, indecisive consumers and investors, unpredictable and unprecedented government fiscal and regulatory policy, record levels of government spending, and a mounting record national debt of $13.7 trillion or roughly 94% of GDP. Real GDP increased at an alarmingly slow pace for the first half of 2010, decreasing from a finalized real growth rate of 5.6% in the fourth quarter of 2009 to 1.7% in the second quarter of 2010. This left second quarter GDP at a level not seen in more than a year. Unfortunately, the third quarter GDP released in October came in at a growth rate of just 2.0%, additional fuel for uncertainty and concern.

Key September/October Data

Positive Signs

According to the latest Manufacturing ISM Report on Business, the manufacturing sector of the U.S. economy continued to grow in October as evidenced by the Purchasing Managers Index remaining at a healthy level of 56.9%. U.S. productivity remains near record levels while cash balances for corporations are at an all-time high with non-financial based U.S. corporations holding more than $1.95 trillion for investment. Private sector employment remained positive edging up by 159,000 jobs in October according to the Bureau of Labor Statistics. The fixed mortgage interest rate stayed at a near record low of 4.30% while the survey of consumers intending to purchase an automobile over the next 6 months remained positive in October. Finally, the Conference Board's Leading Economic Indicators for the U.S., Europe and China were positive in October growing at a .3%, .7% and .3% respectively. The U.S. savings rate continues to be strong realizing a rate of 5.8% in October. Finally, the Dow Jones Industrial Average climbed 326 points last month, which was a continuance of the strong September pace. Automotive sales increased 13.4% in October. The Conference Board Report on Consumer Confidence turned positive in October growing to 50.2 from 48.5 in September.

Negative Signs

Less than impressive job growth ended the month of October with concern for U.S. investors and the economy as a whole. The U.S. dollar index dropped 3.6% in October to the lowest monthly level since January 2010 versus the Euro. Gold rose above $1,400 an ounce and silver surpassed $27 an ounce, respectively in October, coupled with recent FED policy giving us further reason to be concerned regarding future inflation. The U.S. unemployment rate remained static at 9.6% in October with 14.8 million Americans unemployed and 5,000 temporary census taker and other government jobs eliminated in October. Employment dropped by 31,000 in the arts, recreation, and manufacturing, while unemployment benefits remain at the record high extension of 99 weeks. Pending home sales declined in October 1.8% compared to September.

Current Issues

Now that we have entered the post November 2nd election period, it seems appropriate to focus some time on the size of our national debt and the cost of financing it. At the writing of

this piece, the national debt of the United States has just surpassed $13.7 trillion and probably will be north of $14 trillion by year-end. If one compares our $13.7 trillion U.S. national debt to our estimated $14.6 trillion expected U.S. GDP for 2010, we have a U.S. national debt to U.S. GDP ratio of roughly 94%. This ratio is at a near record level in the post World War II era, and greatly curtails the flexibility of the U.S. economy. Historically, governments finance their activities through one or more of the following processes: a) taxation, b) borrowing, or c) inflation (excess printing of currency). The difficulty posed to the U.S. economy by today's record level national debt is that we have the second highest corporate income tax rate in the industrialized world (OECD) at 39.27%, which is also higher than the corporate income tax rates of China (25%), India (33.99%), and Russia (20%). We believe that an increase in our already high corporate income tax would stall our fledgling U.S. recovery. Much talk in Washington has been directed at increasing taxes on the wealthiest 1% of individual income tax earners to reduce the national debt without much attention being paid to the fact that the top 1% of income earners paid 40% of all personal income taxes in the U.S. last year...and create the majority of jobs. We can all agree that our government has borrowed beyond any sound economic model for decades with our national debt at $13.7 trillion. What most Americans do not realize is that our interest payment (no payment on principle) on the U.S. national debt in fiscal year 2009-2010 was $414 billion dollars financed at a historically low average interest rate of just 3.05%. If the economy recovers to a more robust pace of growth or if inflation begins to rise, we could easily see an average interest rate to finance the national debt reach 6-7% on what will likely be a $16-$17 trillion U.S. national debt within 3-4 years. It is not unthinkable that Americans could be paying $800 billion to $1 trillion annually for just interest on the U.S. national debt by 2015.

It is time for Washington to make the same fiscal sacrifices that most American households have been making for a decade. If not, we fear austerity problems like those currently facing Greece and Great Britain, or inflation levels similar to those confronted by Americans from 1978-81 (inflation ranging from 10-13 percent) could be a reality here sooner than later.

Conclusions

Our concern regarding a double dip recession in 2011 or 2012 is still present, but we are more hopeful as a result of the November 2nd elections. The above is just one of the many problems our nation faces which calls for bipartisan cooperation in Washington and a decidedly more pro-business public policy focus across the country.

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