The Beryl Consulting Group LLC

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Good Economic News vs. Bad Economic News: The Dumbbell Effect

We continue to see divergent streams of data on the US economy. There are flows of good news and flows of less bad, but far from good news. There is a macroeconomic dumbbell forming, defined by areas of strength at either end of a central void. The middle portion of the recovery is dramatically absent. Financial asset markets and large, globally diversified firms have begun the rebuilding process. Bond demand is red hot. Average American households are spending more, as savings rates fall. The labor market remains very weak and rates of delinquency, default and personal bankruptcy remain near crisis levels. There were more than 158,000 bankruptcy filings in March 2010. This is the highest number of filings since the surge that preceded the bankruptcy reform of late 2005. Consumer credit outstanding has been declining for 5 quarters and is negative year to date in 2010.

State and local finances are very weak. We see service cutbacks cross the US as many states rush to reduce deficits ahead of the June 2010 end of their 2010 fiscal year. Most states will begin their fiscal 2011 year on 01 July 2010. There has been an increase in tax revenues over the last few months for many states. However, projected shortfalls of over $160 billion remain for the 12 months beginning in July 2010. We would need to see far better recovery numbers on jobs and housing to move back toward the black. States and towns will continue to make painful and deep cuts in services and employment over the next few months. [1] Our local and national headlines are clogged with stories of closing schools and lay-offs of state and local employees. This will get more dramatic in the lead up to 01 July 2010. Table A-14 of The Bureau of Labor Statistics (BLS) informs us that government workers' unemployment rate has increased from 2.8% to 3.9% between March 2009 and March 2010. 283,000 government workers have become unemployed since March 2009. These numbers will grow and be hard to spot as the Census hires tens of thousands in the coming months.

Labor markets and home values remain at or near half century weak points. This remains the center of the economic story as wages, wage growth and home values support the majority of households. The dumbbelling of the economy occurs as we see areas of strength in an economy with a missing center. Consumption spending fueled GDP will remain under pressure - if less pressure. We expect to see better employment numbers for the next few months. We don't expect to see millions of net hires to high wage jobs. We know that consumer credit conditions will remain difficult as the struggle to repay past borrowing will overshadow new credit provision. Households remain limited by low savings rates, very limited access to credit, weak labor markets and immobility from under water homes. Across March 2010 the average wages earned in the US fell.

The average seasonally adjusted wage in the US went from $22.08 in March 2009 to $22.47 across the last 12 months. This massive wage increase would result in $780 in pre-tax annual income with a 40-hour week. Our average work week is only 34 hours, so this increase would be $663 per year before taxes and inflation. Over the last year we have seen a 1.7% increase in wages and 2.1% increase in CPI, consumer prices. Our average wage earner is earning a lower purchasing power adjusted wage. Through the end of 2009 we recorded annual productivity gains of over 3.8%. American workers are producing more despite falling hours and fewer co-workers. All this suggests that we are working harder, fewer hours and producing more with stagnant to falling wages. This is not how sustainable household purchasing power is rebuilt. This will create some more hiring. How much? At what wage and benefit rates? The recent strong retailing numbers suggest we are buying more, hence the rising optimism and economic forecast. It is worthy of note that we achieved the extra purchasing over the last few months by reducing our savings rate from 3.4% of disposable income to 3.1% of disposable income from January through February 2010. This suggests that heavily debt burdened households have falling savings and flat wages with which to rebuild. Yes, employment numbers will improve. No. we are not yet verifiably on a sustainable recovery course.

Slacks in the system have been reduced by booming corporate profit rebound and massive government stimulus from monetary and fiscal policy. Going forward, monetary stimulus will be very slowly and partially reduced. State and local cuts will reduce the impact of what remains of Federal stimulus spending. Monetary policy easing has been done bigger and bolder than ever before. The Federal Reserve will be tentatively and incrementally withdrawing some of the most expensive and extensive stimulus measures that the world has ever seen. Begging in the second half of 2010 the fiscal stimulus associated with the Recovery Act will begin to fade. It is not yet clear if the private economy will strengthen enough to keep growth up as these programs are wound down.

The last piece of the puzzle to watch closely remains the ability of America's government and corporations to continue to be able to borrow so much and so cheap. Corporate bonds and US Treasury Securities have been sold in breathtaking quantities and at low rates of interest. The vast floods of borrowing that flowed to housing, in the lead up to that massive bubble, have been flowing to governments and corporate bonds for over a year now. This has created a situation where firms and governments are borrowing vast quantities at very low cost. Lower rated bonds, including junk bonds, are having their best year in memory. If investors get nervous, interest rates will rise and credit availability will be reduced. We will also see losses on the enormous bond portfolios that investors have built. Today's bond boom is wind in the economic sails. This could change in a rapid and disorderly fashion before a real and balanced recovery is in place.

Our recovery remains very vulnerable and unevenly distributed. It remains too early to be as confident as increasing number of pundits and prognosticators are today.