

# The Economic Recovery Is Well Underway

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When it comes to the economy and financial markets, good news has far outweighed bad news in 2009. Just about every piece of economic and financial market data is tracing out a V-shaped recovery. One would think that this would lead to a little more optimism from the conventional wisdom crowd, but it doesn't. With unemployment at 9.8% last month and the economy still losing jobs at an elevated pace, people are worried. Many fear a W-shaped economy, otherwise known as a double-dip recession.

These fears are overblown. The only double-dip recession of recent decades happened in the early 1980s, when the country was in the grip of "stagflation" and the Federal Reserve ran a roller-coaster monetary policy. The federal funds rate more than doubled—to 17% from 7%—between 1978 and 1980, putting the brakes on inflation but causing the first recession. The Fed then cut the funds rate to 9% in 1980, causing a 12-month recovery, and raised it back above 19% in 1981, causing the double dip. No one in their right mind expects Ben Bernanke's Fed to hike then slash rates anywhere near those extremes.

Meanwhile, the economy and financial markets are not cooperating with the double-dip crowd. Since March 9, when investors realized mark-to-market accounting rules would be

corrected, the Dow Jones Industrial Average is up 51%, the S&P 500 is up 58% and the Nasdaq is up 69%. The NYSE Financial Stock Index is up 137% and bond market risk spreads have narrowed considerably, suggesting that investors are confident the crisis has ended.

By nearly every measure, the economy is tracing out a V-shaped recovery. The pouting pundits of pessimism say that people aren't spending, but retail sales (excluding autos) are up at a 3.9% annual rate so far this year versus double-digit declines late last year. Manufacturing has turned the corner (the ISM Manufacturing Index has been above 50 for two straight months), imports and exports are bouncing back, commodity prices are up significantly, and real GDP is set for solid gains of 3%-4%.

Housing has turned the corner as well. After bottoming in January, new home sales are up 58% at an annual rate. Housing starts have also bottomed, housing inventories have plummeted, and home prices are on the rise. The S&P/Case Shiller 20-city index shows that home prices are up for two consecutive months and have risen in 15 out of 20 cities during the past three months.

Yes, unemployment rose to a new high of 9.8% in September. But the U.S. was losing 700,000 private-sector jobs per month at the

beginning of the year and has seen that monthly total shrink consistently ever since to an average of 196,000 in August and September. There was a one-month hiccup in June, when job losses accelerated, and then another hiccup in September. But the trend is clear, and smaller job losses will give way to job gains.

Jobs are always a lagging indicator, but there are three other contributing factors to the current lackluster jobs numbers. First, CEOs are skeptical of the recovery and tentative about hiring. And productivity is allowing more production with fewer workers. But productivity can only hold off new hiring for so long. With inventories at rock-bottom levels, consumer spending on the rebound and profit-margins wide, job growth should expand sharply in the quarters ahead. Expect positive job growth in late 2009 or early 2010.

The two factors that could undermine growth in the long run are bad government policy combined with global competition. Foreign sales represented more than 48% of all the revenue of the S&P 500 in 2008 (up from 32% in 2001). What this means is that companies have even more reason to locate production facilities and employment in many other locations around the

world. Massive deficits and large new government spending plans mean that U.S. tax rates are likely to go higher. But Germany, for example, is moving toward tax rate cuts. Germany will gain jobs at the expense of the U.S.

Not helping matters, the U.S. lifted the minimum wage again in July, which hurt job growth in August and September. Government spending cannot "create or save" jobs, as President Obama claims, because it takes from the private sector to give to the public sector. For example, providing a tax credit for small businesses to create jobs (as some currently are discussing) will hold back hiring as employers wait for the government to decide on the

policy. If passed, this credit will be paid for by taxation or borrowing that will crowd out growth elsewhere.

There is no free lunch. If you take a look at the U.S. economy since 1960, the larger the government share of GDP, the higher the unemployment rate. In other words, when it comes to jobs, government spending has a multiplier of less than one—government spending destroys jobs.

Whether or not this recovery continues depends on the course of government policy. If the U.S. passes a costly bill to nationalize the health-care system, a new tax system to reduce carbon emissions, and higher marginal income tax

rates, a European sclerosis will settle in with permanently higher unemployment rates. This will not happen because capitalism failed, but because government gave up on it prematurely.

**—Mr. Wesbury, chief economist at First Trust Advisors LP, is the author of the forthcoming book "It's Not as Bad as You Think: Why Capitalism Trumps Fear and the Economy Will Thrive," out next month by Wiley.**

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