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First Trust

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Monday Morning Outlook

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# It's Not the Government's Recovery

This past weekend, President Obama's top economic advisor, Larry Summers, said the "recession is over." But in the next breath he called for more government action to stimulate the economy, in particular, the pace of hiring.

As far as the Administration is concerned, it is government stimulus that brought us this recovery. Now, it's just a matter of piling on even more government spending to generate job growth.

In one sense we agree completely with Mr. Summers. The recession is over. In fact, the economy has been growing since June. This came as no surprise to us. "An economic recovery should start taking hold by mid-year," we wrote back on February 2 ("Seismic Indicators Sense Some Inner Rumblings"). Remember that bleak time, when many economists thought Great Depression II was on the way and conventional wisdom expected the recession would last until at least late 2009 and maybe well into 2010?

Now, politicians are doing exactly what we warned about back on January 12 ("No Vicious Consumer Cycle") when we said that "any 'stimulus' applied by government has less to do with creating the recovery than letting politicians take credit when the recovery happens."

But it was the reform of mark-to-market accounting, easy money and the normal tendency for free markets to heal themselves from panic that have created the current V-shaped recovery. The federal funds rate has been effectively zero for the past year, even as monetary velocity has revived. Meanwhile, business inventories are at rock-bottom levels which leaves room for production increases and the income gains that come with it. In addition, households have brought down their debt levels and are saving a larger share of their incomes, meaning they are less encumbered by debt obligations going forward.

Others argue that "cash for clunkers" artificially and temporarily boosted the economy, but each passing month makes that argument less plausible. Americans bought cars and light trucks at a 10.4 million annualized rate in October and a 10.9 million pace in November. This is well above the pre-clunker pace of 9.7 million in June.

Comparing November to June shows auto sales are up at a 33% annual rate, and there was supposed to be a clunkers hangover. Imagine what sales would have been in November if we hadn't subsidized them back in July/August!

While the pessimists keep looking for things to worry about – seasonal adjustment factors, sales tax receipts – we are forecasting real GDP will grow in the 4% to 4.5% annual rate range at least through 2010. We also expect the unemployment rate to fall consistently in this next year as well. Unfortunately, government spending and stimulus is costing jobs and growth. The economy would be doing even better and unemployment would be lower if government had stayed out of the way.

Back in the 1981-82 recession, the economy shrank at a 1.6% annual rate for a year and a half. Yet after the Reagan tax cuts took hold, the economy rebounded at a 7.7% annual rate for a year and a half. This time around, the economy contracted at a 2.5% rate for 18 months and is set to rebound at a 4 to 4.5% annual rate. Bigger busts are supposed to lead to bigger recoveries, not smaller ones. But this time, because government spent like crazy, the economy is less dynamic, less robust and less efficient. Summers may be right about the recovery, but he is wrong about the need for more stimulus.

There is a V-shaped recovery underway and it can be credited to the dynamism of the capitalist system, not the growth of government interference in the free market system.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 12-15 / 7:30 am | PPI - Nov | +0.8% | **+1.1%** | | +0.3% |
| 7:30 am | "Core" PPI - Nov | +0.2% | **+0.4%** | | -0.6% |
| 7:30 am | Empire State Mfg Index - Dec | 24.0 | **25.0** | | 23.5 |
| 8:15 am | Industrial Production - Nov | +0.5% | **+0.6%** | | +0.1% |
| 8:15 am | Capacity Utilization - Nov | 71.2% | **71.2%** | | 70.7% |
| 12-16 / 7:30 am | CPI - Nov | +0.4% | **+0.4%** | | +0.3% |
| 7:30 am | "Core" CPI - Nov | +0.1% | **+0.1%** | | +0.2% |
| 7:30 am | Housing Starts - Nov | 0.575 Mil | **0.592 Mil** | | 0.529 Mil |
| 12-17 / 7:30 am | Initial Claims - Dec 12 | 465K | **469K** | | 474K |
| 9:00 am | Philly Fed Survey - Dec | 16.0 | **16.5** | | 16.7 |
| 9:00 am | Leading Indicators - Nov | +0.7% | **+0.8%** | | +0.3% |