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First Trust

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Monday Morning Outlook

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The Economy is Improving, No Thanks to Stimulus

Last Friday morning, just hours before the July employment report, Canada's *Globe and Mail* published an op-ed by Nobel Prize winner and former World Bank chief economist, Joseph Stiglitz. He argued that stimulus spending has been "slow going." He wrote, "…what is needed now is another dose of fiscal stimulus."

According to ProPublica.com only $70 billion out of a total $787 billion (from the February Stimulus bill) has been spent. At an annualized rate, this is equal to about 1% of GDP. No wonder Stiglitz, a dyed in the wool Keynesian, is asking for more fiscal stimulus. Nominal GDP fell at a 5% annual rate between October 2008 and March 2009. Stimulus of 1% covers just 1/5 of the drop. Keynesians can't claim that this relatively small stimulus caused a recovery. They need more spending.

Nominal GDP fell just 0.8% at an annual rate in the second quarter of 2009, mirroring other data which shows a V-shaped recovery is underway from the Panic of 2008. In other words, economic growth accelerated by about 4% at an annualized rate between winter and spring. Unless the multiplier from government spending is 4 (which no one believes), this recovery is being caused by something other than stimulus.

That something is really three things. First, mark-to-market (MTM) accounting was finally relaxed by FASB in the spring of 2009. Stopping the use of "exit" or "bid" prices to value securities, and allowing "cash flow" to be used instead, stopped the hemorrhaging of regulatory capital and ended the vicious downward spiral of collapsing banks and economic activity. Some want to argue that it was the government's stress test of the banks that did this, but the bottom in the stock market correlates perfectly with Congressional hearings about MTM.

Second, the Federal Reserve has been running a highly accommodative monetary policy. The additions of liquidity have put a bottom in nominal GDP growth rates.

And third, the panic that was set off last September by the failure of Lehman Brothers, the proposal of the $700 billion TARP plan and a terrifying speech by President Bush is finally ending. As consumers begin to behave more normally and Fed liquidity flows freely, the economy is recovering nicely.

Broad stock market indices are up nearly 50% from their bottom as corporate earnings have handily beaten estimates. Some say that top-line growth has yet to improve, but with nominal GDP lower today than it was a year ago this is not a surprise. As the economy picks up in the next few quarters, top-line growth will return and profits will improve further.

Dr. Stiglitz wrote his op-ed before the employment report was released last Friday. After the report, which showed the unemployment rate fell to 9.4% and job losses were the smallest since last August, President Obama credited stimulus saying "…we've rescued our economy from catastrophe…" You can decide for yourself who is correct.

But for our money, it is the easy Fed, the end of the panic and reform in accounting rules that is boosting economic activity. Over the next twelve to eighteen months we expect higher stock prices, more inflation, higher bond yields, and a relatively stable dollar. The economy is improving, stimulus or not.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-11 / 7:30 am	Q2 Non-Farm Productivity	+5.5%	**+6.0%**		+1.6%
7:30 am	Q2 Unit Labor Costs	-2.5%	**-3.8%**		+3.0%
8-12 / 7:30 am	Int'l Trade Balance - Jun	-$28.5 Bil	**-$25.8 Bil**		-$26.0 Bil
1:00 pm	Treasury Budget - Jul	-$180.0 Bil	**-$181.0 Bil**		-$94.3 Bil
8-13 / 7:30 am	Retail Sales - Jun	+0.8%	**+1.6%**		+0.6%
7:30 am	"Core" Retail Sales - Jun	+0.1%	**+1.2%**		+0.3%
7:30 am	Export Prices - Jul	+0.4%	**0.0%**		+1.1%
7:30 am	Import Prices - Jul	-0.5%	**+0.2%**		+3.2%
7:30 am	Initial Claims - Aug 8	545K	**543K**		550K
7:30 am	Business Inventories - Jun	-0.9%	**-1.0%**		-1.0%
8-14 / 7:30 am	CPI - Jul	0.0%	**+0.1%**		+0.7%
7:30 am	"Core" CPI - Jul	+0.1%	**+0.2%**		+0.2%
8:15 am	Industrial Production - Jul	+0.4%	**+1.2%**		-0.4%
8:15 am	Capacity Utilization - Jul	68.4%	**68.7%**		68.0%
8:45 am	U. Mich. Consumer Sentiment	69.0	**70.0**		66.0