Shut Out the Pessimists

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You know the economy is getting better when the pessimists' theories on economic doom have been so wrong for so long they have to start recycling the old ones.

Right after the crisis a wave of mortgage "re-sets" was supposed to cause a double dip recession. The idea was that many of the mortgages taken out in the housing boom, particularly interest-only mortgages, had to re-set at higher interest rates or require principal payments, which would eat up workers' meager earnings, in turn reducing consumer spending and putting us back in recession.

Since that gloom never materialized, some analysts are at it again. Now, home equity lines of credit (HELOCs) are going to cause the recession. But, just like the first time this theory appeared, a little number-crunching shows just how small the problem is relative to the size of the economy.

US consumers have a little less than $500 billion in outstanding HELOCs right now, according to the NY Fed. So let's make the outrageously pessimistic assumption that ALL of them re-set overnight and annual payments on these loans have to double, from about $25 billion per year (5% of $500 billion) to $50 billion per year. That extra $25 billion is only 0.2% of annual consumer spending. In other words, there's nothing to this theory.

The other recession theory grabbing attention is about a tiny portion of the federal budget that is supposedly signaling that all the other bullish reports on the job market are missing the boat. Tax revenue from federal unemployment taxes (or FUTA, a levy on businesses that funds the unemployment insurance program) totaled only $47.2 billion in the past year, versus $66.6 billion back in Fiscal Year 2012. That decline shows that the quality of jobs is heading down and that we are either headed into a recession or there already.

Anyone who makes this argument ought to have his economic credentials revoked, because they clearly don't know how unemployment insurance works. When the US enters a recession, some states end up borrowing money from the federal government, which they repay when the economy starts to heal. Those repayments come in the form of states temporarily getting a smaller share of unemployment tax revenue and the federal government getting a larger share, which is exactly what happened in 2010-2012. Once the repayments are done, states go back to taking more and the federal government takes less.

This pattern is nothing new. Federal unemployment tax revenue surged after the 1981-82 recession, peaking in 1984-85. Stagnation in FUTA receipts after 1985 had nothing to do with slow job growth. The US added 12.4 million jobs from mid-1985 through mid-1990. These receipts also surged after the 1990-91 recession, peaking in 1995. We then added 14.5 million jobs in the next five years. In other words, a peak in FUTA early in an expansion is completely normal.

But the worst part of the analysis is the assertion that federal payroll tax revenue is falling. That's completely untrue. Federal payroll taxes (like Social Security and Medicare) have been $1.1 trillion in the past twelve months, a record high on both an overall and inflation-adjusted basis. And that's true whether you adjust by using the overall consumer price index or the "core" index, which has grown faster because it excludes food and energy.

Even Brexit is having trouble causing the British recession so many feared. British jobless claims fell in July, after Brexit, while British retail sales spiked higher. So much for the end of the world.

Look, someday a recession is going to happen. But with monetary policy loose, tax rates relatively low, and free trade still holding up, it's not happening anytime soon. Smart investors need to focus on the truth and shut out the pessimists.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-23 / 9:00 am	New Home Sales – Jul	0.580 Mil	**0.558 Mil**		0.592 Mil
8-24 / 9:00 am	Existing Home Sales – Jul	5.510 Mil	**5.420 Mil**		5.570 Mil
8-25 / 7:30 am	Initial Claims – Aug 22	265K	**264K**		262K
7:30 am	Durable Goods – Jul	+3.5%	**+3.6%**		-3.9%
7:30 am	Durable Goods (Ex-Trans) – Jul	+0.4%	**+0.6%**		-0.4%
8-26 / 7:30 am	Q2 GDP Preliminary Report	1.1%	**1.1%**		1.2%
7:30 am	Q2 GDP Chain Price Index	2.2%	**2.2%**		2.2%
9:00 am	U. Mich Consumer Sentiment- Aug	90.7	**90.4**		90.4