

Politics and Pessimists

Politics and economics don't mix well. When unemployment is high, no politician in their right mind would say "things are getting better" – even if they are. And when your party is out of power, no matter what the economy is doing, it's always good to point out some data, or forecast, or sector that is not doing well. As a result, there is no political constituency for economic optimism and this has created an awfully pessimistic environment.

Add to this political quagmire the largest pool of assets and asset managers ever to be deployed on the side of short-selling and what you get is at least a serious case of denial, or at most a willingness to ignore or obfuscate anything that might be positive about the economy.

Don't take this in the wrong way. The US economy has its problems – we don't deny that. But, the recession has ended, growth has returned and signs point to an acceleration in the growth rate ahead.

For example, the pessimists are all talking about the fact that real GDP will be revised downwardly to an annualized growth rate of about 1% in the second quarter. What they don't tell you is that this low number was caused by a 35% surge in imports. That's right, consumers and businesses bought more from overseas (lot's more), and since imports are a negative in the GDP accounts, it made the economy look worse. When we adjust for this, American households and businesses increased their spending at a 4% annual rate in the second quarter – over and above inflation. In the last 20 years, this measure, which looks at just spending by domestic purchasers, increased at an average 2.8% annual rate. In other words, despite high unemployment and low consumer confidence, spending grew rapidly in the spring.

So, what about the future? First, consumers are in a better position to spend today than at the start of the year.

The personal saving rate is now at 6.4%. Excluding spikes due to special temporary government transfers, this is the highest level since 1992. Meanwhile, due to longer hours and higher pay per hour, private sector earnings are rising. So far this year, real (inflation-adjusted) cash wages are up at a 3.4% annual rate.

Second, business balance sheets are chock full of cash, earning essentially zero return, that can and will be put to work enhancing productivity.

Although some analysts bemoan lingering excess capacity, they need to look more closely at the data. In the past year the real economy has grown 3%. During that time, the utilization of industrial capacity has climbed from 68% to 74%. That climb, in part, is due to falling capacity as the capital stock depreciates. One more year of 3% growth, and capacity use could be at 80%, which is higher than the average in the past 30 years.

Forward-looking companies can see this already and have already started investing, which is why investment in equipment and software is up at more than a 20% annual rate so far this year.

Third, home building remains at such unsustainably low levels that it can support both a rebound in construction and a continued rapid drawdown in excess inventories.

In the end, the underlying forces of economic growth have turned the corner. At the same time, the Fed is accommodative and unlikely to change its stance. These two factors alone will prove the pessimists wrong.

Finally, the political winds are howling toward a divided government. The odds of putting off a tax hike in 2011, and possibly reversing healthcare legislation cannot be ruled out. Add this to the mix, and the future could get a sharp boost to the upside that makes short-sellers very uncomfortable.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-16 / 7:30 am	Empire State Mfg Index - Aug	8.0	10.0	7.1	5.1
8-17 / 7:30 am	PPI - Jul	+0.2%	+0.3 %		-0.5%
7:30 am	"Core" PPI - Jul	+0.2%	+0.2%		+0.1%
7:30 am	Housing Starts - Jul	0.560 Mil	0.562 Mil		0.549 Mil
8:15 am	Industrial Production - Jul	+0.5%	0.7%		+0.1%
8:15 am	Capacity Utilization - Jul	74.5%	74.7%		74.1%
8-19 / 7:30 am	Initial Claims - Aug 14	478K	470K		484K
9:00 am	Philly Fed Survey - Aug	7.0	4.3		5.1
9:00 am	Leading Indicators - Jul	+0.1%	+0.3%		-0.2%