

We Remain Positive About 2016

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The Arab Spring is turning into an Islamic Winter, with some added cold wind, reminiscent of the Cold War – as Russia and Iran are seemingly aligned against a US-backed Saudi Arabia and Turkey. The intricacies of the religious, political, military, and historical events taking place are enough to give any normal person a headache. “Outrageously unstable,” is an understatement. Millions of refugees are voting with their feet.

To make matters worse, China is in trouble. We don’t expect a collapse, but central-planning always fails. Joseph Stiglitz, former World Bank Chief Economist, who has argued that China is a model for the US, has some explaining to do.

Add to these uncertainties the recent rate hike by the Fed, and it’s what we would call a field day for the Pouting Pundits of Pessimism. Chaos and uncertainty are their friends, and they have unlimited running room to make up whatever “end of the world” horror stories that can be conceived.

But (and, yes, we have a “but”), the US economy has continued to grow, just like it did in the 1990s after the Soviet Union and Japan collapsed at the same time. Growth is slower in the 2010s than it was in the 1990s, but it’s still growth.

We won’t know fourth quarter, or full-year, 2015 growth for another month, but we suspect Q4 real GDP will be around 1.5%. This means US real GDP expanded at 2% in 2015, slightly less than real growth of 2.5% in 2013 and 2014.

For us, three things stand out when we look at 2015. First, the US grew in spite of a massive decline in oil prices. Second, 2014 tapering by the Fed didn’t stop growth. Third, in fiscal-year 2015, the size of the US federal government grew for the first time since 2009 as a percent of GDP. That’s not good.

Let’s take these one at a time. First, conventional wisdom has always viewed a fall in energy prices as a “tax cut” for the economy. Since everyone must use energy, a decline in the price supposedly boosts productivity and demand.

Clearly that didn’t happen in 2015. Energy prices are really a two-way street, with winners and losers. Falling prices help consumers and energy-using companies, but hurt drillers and ancillary support activities. Orlando wins, Fargo loses.

Second, we never viewed QE as a driver of growth, so we never thought tapering would hurt the economy. In fact, during the 52 weeks ending 12/23/15, the M2 money supply grew 6.1%, and commercial and industrial loans grew 11%. No slowdown.

The same is true of the most recent interest rate hike. Before the rate hike, the banking system held roughly \$2.5 trillion in excess reserves. After the rate hike the banking system holds about \$2.4 Trillion. The rate hike had little effect on the money supply at all, and the world is still awash in dollar liquidity.

Finally, if you are really looking for a culprit for the drop in real GDP growth rates during 2015, look no further than the size of government. In Fiscal Year 2015, federal government spending was 20.7% of GDP, up from 20.3% of GDP in 2014.

That might seem small, but when the GOP busted the Sequester it led to the first increase in the government’s share of GDP since 2009. This is the real headwind to growth. Every dime the government spends must be taken from income. The bigger the government, the smaller the private sector and the weaker growth becomes.

For 2016, the same forces are aligned. The entrepreneurial spirit will continue to push back against the weight of government spending, taxation and regulation. In addition, market participants will deal with the fog of war in the Middle East and flailing attempts by Chinese central-planners to boost growth using command-and-control.

Look, we can’t promise anything. But, in spite of the increase in the past year, government is no bigger today than it was three years ago, stocks remain undervalued, and money isn’t tight. In spite of the huge decline in stocks today, the first trading day of the year, we remain positive.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-4 / 9:00 am	ISM Index – Dec	49.0	48.8	48.2	48.6
9:00 am	Construction Spending – Nov	+0.6%	+0.6%	-0.4%	+1.0%
1-5 / <i>afternoon</i>	Total Car/Truck Sales – Nov	18.0 Mil	18.0 Mil		18.1 Mil
<i>afternoon</i>	Domestic Car/Truck Sales – Nov	14.2 Mil	14.3 Mil		14.0 Mil
1-6 / 7:30 am	Int'l Trade Balance – Nov	-\$44.1 Bil	-\$45.6 Bil		-\$43.9 Bil
9:00 am	ISM Non Mfg Index – Dec	56.0	56.1		55.9
9:00 am	Factory Orders – Nov	-0.2%	-0.5%		+1.4%
1-7 / 7:30 am	Initial Claims – Jan 2	275K	280K		287K
1-9 / 7:30 am	Non-Farm Payrolls – Dec	200K	185K		211K
7:30 am	Private Payrolls – Dec	197K	175K		197K
7:30 am	Manufacturing Payrolls – Dec	0	0		-1K
7:30 am	Unemployment Rate – Dec	5.0%	5.0%		5.0%
7:30 am	Average Hourly Earnings – Dec	+0.2%	+0.2%		+0.2%
7:30 am	Average Weekly Hours – Dec	34.5	34.5		34.5
2:00 pm	Consumer Credit– Nov	\$18.5 Bil	\$19.6 Bil		\$16.0 Bil

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.