Four Corners Economic Quarterly

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Office of Business and Economic Research, School of Business
Fort Lewis College, Durango Colorado

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Expectations for 2010

By: Dr. Luke Miller

As an investment advisor, many ask my opinion regarding the future of a range of asset classes to include stocks, bonds, real estate, and commodities. Keep in mind I am a financial analyst, not an economist. While we share similar educational training, the economist focuses more on what may occur, focusing less on when it will occur. Usually the consensus economists 'predictions do come true; however, there are many subtle things behind the scenes impacting timing. One saying of those in finance, in regards to economic predictions, is that "the market can stay irrational longer, than many can stay solvent."

Where do I think the economy is headed in 2010? Putting on my economist's hat, I would say the economy is not on a solid foundation -- consumer debt ratios are too high, small businesses are hurting, and homebuilding is slow.

Where do I think asset classes like stocks, real estate, and commodities are headed in 2010? One word – up. Why the disparity? Liquidity, liquidity, liquidity… An unprecedented synchronized global upswing is under way being driven by 787 global, stimulative policy initiatives that have pumped or plan to pump trillions of dollars into world economies. The amount of money that global central bankers and governments created and have infused into the world financial system is unparalleled on a scale that most of us cannot even begin to imagine. It's virtually impossible this money will not create a liquidity bubble of massive proportions over the next few years. In my opinion, this liquidity bubble will create many opportunities on the upside over the next year or two; and many opportunities in the aftermath of it popping further down the road.

Putting on my economist's hat, I would say the economy is not on a solid foundation

As a financial analyst, it is not my job to question these stimulative policy initiatives and pontificate the pros and cons of already adopted economic measures. As a financial analyst, I am concerned with financial wealth creation and preservation. As such, here are some of my predictions for 2010:

1. Employment is likely to increase quicker than many are predicting, as companies cut too many people than needed over the last 18 months.
2. Capital expenditures by companies will increase; documented by dozens of multinational corporations stating So in their quarterly conference calls.
3. A lower US dollar will continue to boost US exports and asset prices.
4. Over the last 18 months companies have lived off their inventories leading to a record decline. This year US companies will begin the cycle of re-stocking inventories which will lead to a 3% GDP independent of the US consumer.
5. Home prices will stabilize and possibly increase over the next 12 months.
6. Although credit is not available to small businesses, large companies are and will continue to borrow with ease in the debt and equity markets. In fact, large companies have such good access to capital, a near record number of stock buybacks have been announced for the coming year.
7. Foreign economies have and will continue to exhibit spectacular growth. For example, Chinese industrial production is up 19% and electricity production is up 27%. China's imports have surged 54%, Chinese vehicle sales are up 100%, India vehicle sales are up 50%, Brazil's economy is growing at 5%, Turkey's GDP is up 11%, China's GDP was up 13% in December 2009, etc…

One word of caution – although I believe the trend is up for asset classes over the next year or so, expect some volatility along the way. Additionally, like all bubbles, they never end orderly. Use this year to ride gains and position yourself for another correction virtually guaranteed to occur once these stimulative policies have run their course.

The Long Recovery of the Labor Market

By: Dr. Robert Sonora

There has been some good news from the various statistical agencies which track macroeconomic data. From the Bureau of Economic Analysis comes news that the US economy grew at annual rate of 5.7 percent in the fourth quarter of 2009 (2009.4). This news comes on the heels of 2.2 percent growth in the third quarter (2009.3). Figure 1 shows the annualized quarter to quarter growth rate (in red) and the year to year growth rate (blue), from 2000-2009. On the other hand, if we compare growth from 2008.4 to the 2009.4 the economy grew just above 0% from the previous year. Not so good.

I don't see the "long run" unemployment rate … falling below eight or 8.5% for some time.

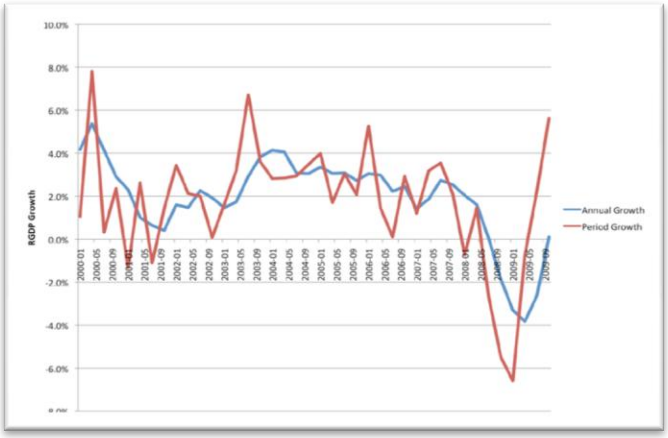

Figure 1 Real GDP growth, Annual Growth (blue) and Annualized Quarterly Growth (red)

With this news comes back-to-back quarters of household consumption and double digit export growth. And to add to the good news, labor productivity also increased in the fourth quarter.

In the meantime, the unemployment rate fell from a twenty-eight year high of 10.1 percent to 9.7 percent in January, Figure 2. The annual decline in industrial production is slowing, see Figure 3. And capacity utilization, rose to about 72% from a low of, the lowest since 1967, 68.3 percent in June of last year. Figure 3 shows the economy beginning to raise its capacity to 80%, the approximate average over the period 1967-2008.

But as is well documented, there is still weakness in the labor markets. Many economists are saying the unemployment rate, the blue line in Figure 2 below, will not fall below nine percent for the foreseeable future, as in two years. And I don't see the "long run" unemployment rate, the black trend line, falling below eight or 8.5% for some time.

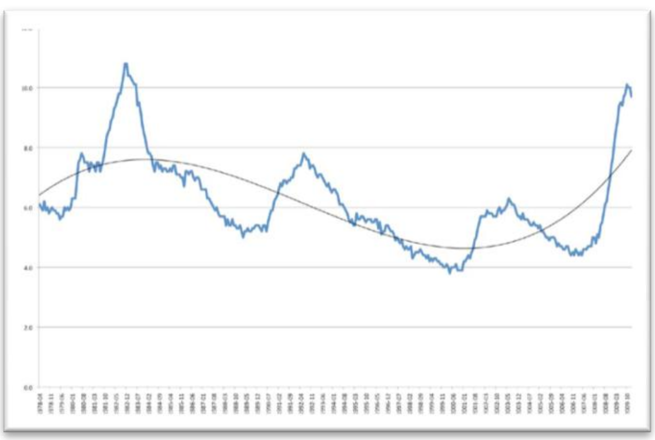

Figure 2 Unemployment (blue) and the Long Run Unemployment Rates (black)
Source: Bureau of Labor Statistics

Figure 3 Capacity Utilization and Annual Industrial Production Growth
Source: FRED II, Federal Reserve Bank of St. Louis

Why not? There a couple of reasons that are apparent at the moment. First, is the length of unemployment. The average length of unemployment in the US over the past 20 years has been about fifteen weeks. In January, it reached 30.2 weeks, the highest it's been since they started collecting this data in 1948. And while the unemployment rate has been falling, this continues to rise.

Second, the US labor market is relatively dynamic, thus the majority of workers are unemployed less than five weeks. The number of chronically unemployed workers, those unemployed for more that 27 weeks is generally about a half those unemployed less than 5 weeks.

But in January that ratio became flipped and the number of chronically unemployed workers hit 6.3 million. Figure 4 shows the ratio of the number of chronically unemployed workers to those unemployed less than 5 weeks.

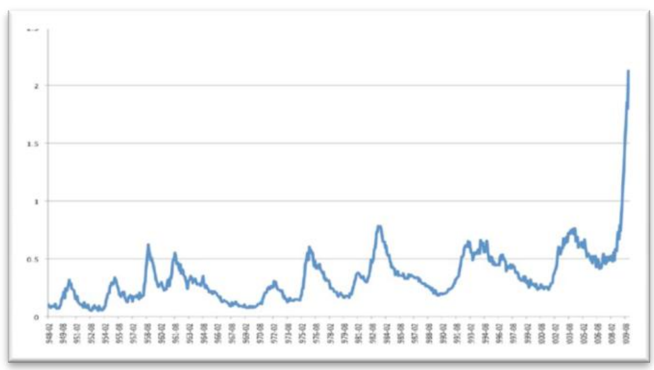

Figure 4. Ratio of Unemployed > 27 Weeks to Workers Unemployed < 5 Weeks
Source: Bureau of Labor Statistics

What about the total loss of non-farm manufacturing jobs lost since December of 2007, the official start of the Great Recession? We lost 2.2 million (in blue). Indeed the US has lost 4.3 million manufacturing jobs since November, 200, the end of the first Bush recession (red), see Figure 5 below.

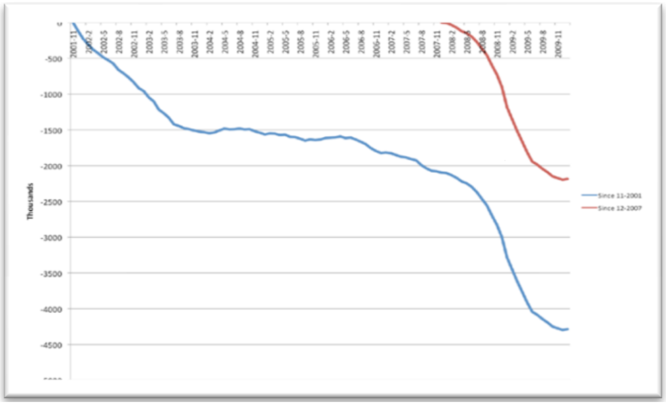

Figure 5. Non-Farm Manufacutring Jobs Lost (Source: Bureau of Labor Statistics)

Finally, what about spending patterns of Americans? In 1990, household debt was about 82 percent of disposable income. In 2008 the debt-to-income ratio was 131 percent, Figure 6. And household consumption rose from 66 percent of GDP to 70.8 percent, see Figure 7.

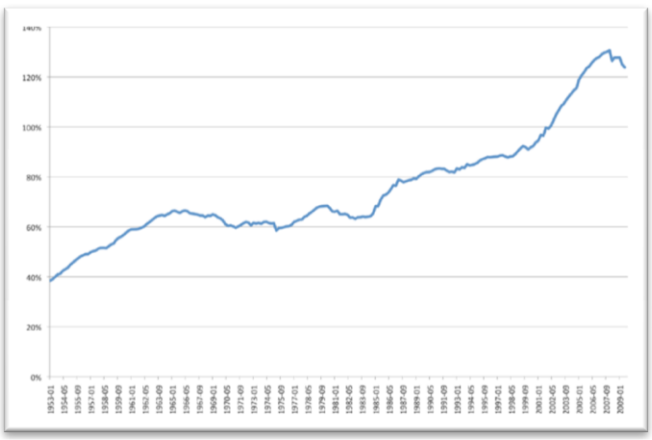

Figure 6. Household Debt to Disposable Income

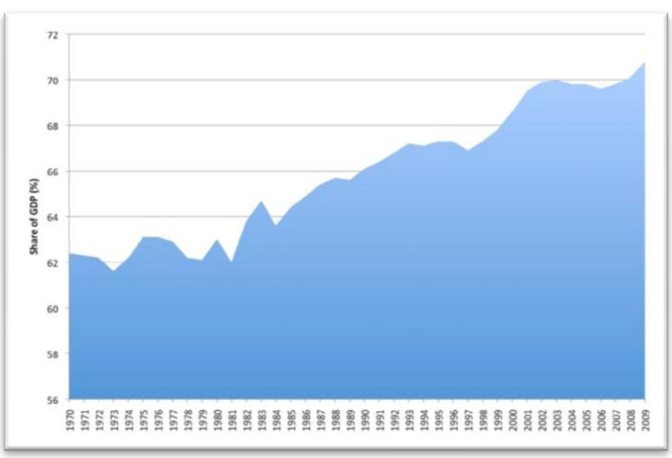

Figure 7. Household Consumption Share of GDP source: Bureau of Economic Analysis

The first two points will concern us in the short run. Some of the surplus workers will eventually be pulled back into employment. But not all of them. Workers once employed in manufacturing, construction, retail, and relevant support sectors, will lose those jobs, possible forever. And it will take time to retrain these workers in whatever jobs will be available in the post Recession period. Hence, the high rate of "long run" unemployment discussed above.

There are still considerable hurdles we must still overcome – residential and commercial property foreclosures, structural changes in the economy, etc. – before we see any meaningful long run improvements in labor markets. Yet another "jobless" recovery, and this one will be exacerbated by the considerable structural shifts away from manufacturing, retail, etc.

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