AMERICA

Unemployment and luke-warm demand hamper recovery

by Vanessa Drucker

“The American economy is growing sluggishly, but still not fast enough to absorb the excess labour capacity left over from the previous downturn”

Gross domestic product (GDP) is volatile by nature, backward-looking and subject to significant revisions. This year, American economic growth has indeed climbed, albeit at a modest pace, from a paltry 0.4% rate in the first quarter, to 1.3% in the second, to a somewhat brisker 2.0% in the third, having been revised down last week from an estimated 2.5%. The expansion is less than stellar, given that rates typically exceed 3% during a recovery period.


David Levy

Some of this year’s volatility is attributable to factors originating far from American shores. The Middle Eastern uprisings of the “Arab spring” provoked a huge run up in oil prices in a supply side shock. Energy spikes affect a range of economic activity, from transport to heating to industrial costs. Another distant event, the Japanese earthquake and tsunami, disrupted supply chains and inventory growth. Some of those temporary pressures from earlier months have been reverting to their means, restoring the momentum in growth for a stronger second half of the year.

In addition, longer-term problems of economic measurements have muddied the picture. Abrupt shifts in the economy that affect seasonal patterns, as well as changing data collection problems, may have created misleading indications, says David Levy, the chairman of the Jerome Levy Forecasting Center in Mount Kisco, New York. Government statisticians adjust for seasons, taking into account phenomena like a normal surge in construction spending in spring and summer.

“The dramatic shrinkage of the smaller industry in recent years affects broad aspects of the economy – employment, layoffs, consumer and capital spending – and inevitably impacts seasonal adjustments,” Levy explains. Now, the seasonal adjustment in building activity may overcompensate, particularly when the summer escalation is more modest.

Furthermore, the increased use of smoothing and trend projection techniques may account for variations in government statistics. These fill gaps or compensate for inadequacies in raw data collected, especially in times of constrained budgets. Formerly, experienced statisticians were “real mavens, a hands-on dedicated force who stayed for long periods,” says Levy. “Now, they may be younger or less experienced, although more mathematically savvy.”

Drilling down into GDP components, consumers’ consumption, which forms 70% of American GDP, has been “slowly trudging higher,” says Doug Burtnick, a senior investment manager at Aberdeen Asset Management. He describes the dichotomy among American consumers: those employed continue to spend normally, while those underemployed or unemployed are “really stressed”.

Consumer spending, which rose 2.3% in the third quarter, has been supported by surprisingly robust retail data at 7.2%, year-over-year. But that pattern appears unsustainable, to the extent it derives from a drawdown in savings.

“People are spending more than their income growth,” explains Mark McCormick, a currency strategist at Brown Brothers Harriman. The personal savings rate, which peaked in June at 5.3%, has recently slithered to 3.3% in September and 3.5% in October. (Contrast the meagre savings rate with the 15% level of the 1950s.)


Mark McCormick

Business spending appeared initially to have held up, highlighted in aircraft, farm equipment, and oil and gas extraction machinery. But last week’s data reveals that capital spending declined 0.9% in the third quarter, largely owing to transport. That latest revision throws cold water on earlier predictions for a 4.1% rise. Before the revision, Levy had already noted that manufacturers were reducing planned capital expenditures, and that spending on technology seemed to have peaked. “The Conference Board measure of CEO confidence, a reliable leading indicator of capital spending, has dropped off precipitously,” he adds.

No wonder chief executives are hesitant in the face of American regulatory uncertainty and chaotic European finances. McCormick observes that, “as businesses forecast futures sales, they are concerned about global demand, especially exports to Europe”.

Corporate profits, a positive contribution to growth, slowed in the third quarter to $39.8 billion (£25.6 billion), from a $61.2 billion increase in the prior period. Burtnick points out that corporate profit growth, which tends to be uneven, also helps to explain the overall GDP volatility. For example, looking back, profits vaulted 21% in the second quarter of 2009, but only inched up 3% in the same quarter in 2011. “Right now,” he says, “financial service company profits are volatile, with many just beginning to recover from the loan reserves they had previously taken.”

Uncle Sam continues to support the economy – but less vigorously. Fiscal drag in 2011 came largely from contractions in state and local government spending; local authorities must balance their budgets by law. At the federal level, Congress will need to vote again next year on temporary stimulus measures, such as unemployment extended benefits, a payroll tax cut, and depreciation allowances for businesses, which had been enacted in early 2010. Moreover, last week’s failed deficit deliberations will theoretically trigger automatic cuts, destined to eat into government expenditures.

Lastly, net exports retain a brighter gleam. Exports grew 4.3% over the past quarter, versus a subdued rise in imports of 0.5%. These levels also fluctuate significantly. Burtnick calls attention to the swings in both oil prices and currency exchange rates, which has fed through into export volatility.

Weakness in the labour market – unemployment remains mired at 9% – has prompted some pleas to the Federal Reserve to help counteract seemingly in-tractable unemployment. Unlike most central banks, the Fed follows a dual mandate to achieve both price stability and maximum employment. Recent inflation figures have been benign, with corep ersonal consumption expenditure, which excludes food and energy, rising only 0.1% in October, and 1.7% over the past year. Inflation is critical. As long as it is controlled, the central bank is more likely to expand its balance sheet in a third round of easing.

Earlier warnings that America might slip back into a double-dip recession were probably overdone. Economists may have read too much into softer measures, such as confidence surveys, instead of relying on harder data, like industrial production, income or retail sales. Now that recession scare has receded, McCormick sums up the ongoing challenge. “The American economy is growing sluggishly, but still not fast enough to absorb the excess labour capacity left over from the previous downturn.” Or, in other words, despite two years of growth, unemployment is still dragging down the economic recovery.