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Economy strong despite shakiness in some sectors

By Jim Flinchum

As the year began, all the economic data points were good. We were experiencing a synchronized global economic recovery and the U.S. stock market was continuing its relentless climb. Then, while profits of U.S. companies remained strong, the trade war became serious, causing nervous investors to flock to the dollar, which rose in value (aided by the Fed) and crushedthe economies of emerging nations.

Jim Flinchum

After a typically lackluster first quarter, the economy came roaring back in the second quarter. Most other economic indicators remain positive, albeit a little softer in June.

The Index of Leading Economic Indicators continues to rise but at a slower rate. Consumer confidence dropped slightly last month, although it remains quite high. This does not necessarily mean we have reached some apex. It is just as likely to be a "soft spot."

Both the manufacturing and nonmanufacturing Institute for Supply Management indexes remain strong, suggesting further GDP growth. In fact, the backlog of orders is the highest since 2004. The primary internal constraints on growth are transportation and labor. (Some analysts attribute the lack of truck drivers to the opioid epidemic.)

JOB MARKET

While the unemployment rate jumped up from 3.8 percent to 4.0 percent, the long-term unemployed dropped to 7.8 percent, the lowest since the Great Recession.

Our aging workforce found 213,000 new jobs last month. We now have more job openings than people who need/want jobs. But, more low-skilled immigrants will not help.

The Labor Force Participation Rate continues to increase slowly, as more people return to the workforce. The fastest growing demographic in our workforce is the elderly. Who wants a younger worker without skills? Unskilled labor has never been less needed or less valuable. Skills are more important than ever.

STOCK MARKET

Despite setting a new all-time high in January, the Dow lost 1.8 percent over the first half of the year, compared to the broader S&P 500 which rose a mere 1.7 percent. The Russell 2000 index of small companies rose an impressive 7 percent.

Growth stocks continued to trounce value stocks, the former were up 7.28 percent while the latter lost 2.22 percent. Growth and value stocks tend to alternate leadership over time, with the advantage to value when going into a recession.

The stock market hates uncertainty, which has been rising steadily all year. The CBOE Volatility Index (VIX) or "fear index" has risen 45.7 percent this year.

GLOBAL MARKETS

Outside the U.S., global stock markets on average lost 4.9 percent. Turkey's market lost a whopping 16.3 percent, but the 13.9 percent drop in China's Shanghai market is more important, especially as the trade war begins. The Eurozone lost 2.2 percent, while Australia gained that same percentage.

Pay attention to South Africa's stock market, which is down 3.2 percent YTD but dropping fast. South Africa's currency (Rand) was down 7 percent in June alone. Their unemployment rate is 27 percent and rising, compared to a high of 25 percent during the Great Depression in the U.S.

INTEREST RATES

The yield curve is the difference in interest rates between short-term and long-term debt. As that difference decreases, the yield curve is said to be flatter, which can predict a recession. It has flattened this year, as the Fed has raised short-term rates, but the Fed has less control over long-term rates, which have remained relatively flat, primarily due to the influx of flight money from abroad.

Our flatter yield curve may indicate a potential recession or that the Fed is raising short-term rates too fast.

Higher short-term rates also tends to strengthen the dollar, which has risen 2.39 percent this year.

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That is a big rise in only six months and makes our exports more expensive, which hurts our exporters and hurts emerging nations who must buy dollars in order to buy from our exporters or repay dollar-denominated debt.

Year-over-year personal income growth is 2.7 percent. Like the dog that caught the car, the Fed got inflation over 2 percent and doesn't appear to know what to do, except raise rates more.

TRADE WARS

There was no formal declaration of war, but make no mistake, the war has already begun, which greatly increases the dreaded uncertainty that stock markets hate.

While nobody argues that none of our many bilateral and multilateral trade agreements need to be updated, I don't think anybody expected we would declare a trade war with China, with the Eurozone, with Canada, and with Mexico at the same time.

There is nobody alive who can remember such a worldwide trade war. Econometric models are getting migraines, trying to model such a war.

Because China sends 19 percent of its exports to the U.S., while we send a mere 2 percent of our exports to China, we do have the negotiating advantage, especially since their economy is more export-oriented, compared to our more service-oriented economy. As an opening volley in our trade war, China devalued its currency 3.4 percent last month, meaning China will almost surely import less from us.

There is a general fear the Chinese could hurt us by not buying our Treasury debt, but that is old news as they slowed those purchases some years ago. There is scant possibility we could not sell enough Treasury bonds to keep functioning.

Don't forget that "quantitative easing" was used to lift us out of the Great Recession. Our deficit spending was financed by the Treasury selling bonds to the Fed. (In other words, the right pocket was buying bonds sold from the left pocket.) That tool alone will largely insulate us.

A BIGGER PROBLEM

We are obsessing over the trade war, which is more short-term than the bigger long-term problem of our national debt. We have two deficit-producing political parties – Republican and Democratic. The Republicans produce deficits by lowering taxes, and the Democrats produce deficits by increasing spending.

Republicans genuflect to supply-side economics, arguing a tax-cut stimulates the economy, which it does, sometimes. Democrats genuflect to Keynesian economics, arguing increased spending stimulates the economy, which it does, sometimes.

The result is that our national debt is over $21 TRILLION, which is a dangerous 105 percent of our GDP, and the Trump tax cut is expected to add another $1.8 trillion.

No elected official is truthful enough to admit we need both higher taxes and less spending, which would really be "telling it like it is!"

To see something, go to:
www.USDebtClock.org.

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