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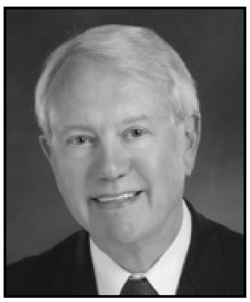
THE ECONOMY

The good, the bad, and the deficit

By Jim Flinchum

The stock market: The stock market was great during the third quarter. The Dow was up 7.6%, the S&P 500 up 8.5%, and the Nasdaq up 11%. The S&P and the Nasdaq set all time records during the quarter. Over the last two quarters, the S&P 500 rose 26%, while the Nasdaq rose 45% from the March low— the best performance since 2000.



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That great stock market performance is skewed by the incredible performance of the six Big Tech companies, especially those benefiting from stay-at-home. There was the S&P 6 and the S&P 494, with the S&P 6 pulling up the whole market and giving a misleading impression. There is considerable speculation about the number of younger, recently unemployed stock buyers sitting at home, buying up "cult" stocks, such as Zoom or Tesla.

On a year-to-date basis, the Dow Jones Industrial Average is down 2.7% the S&P is up 4.1%, and the tech-heavy Nasdaq is up a whopping 24.5%.

Worldwide, the U.S. stock market looks even better. The Eurozone was down 12.4%, Australia down 13%, Hong Kong down 16.8%, Brazil down 18.2%, Russia down 23.9%, and Spain down 29.7%.

The labor market: The final report before the election showed unemployment dropped from 8.4% to 7.9%. (It was 12.1% for Blacks and 7.4% for Whites.) Economists predict the average unemployment rate for 2021 will be 6.8%. Underemployment (U-6) dropped from 14.2% to 12.8%.

Last month, the private sector produced 877,000 jobs, but total jobs produced was only 661,000 because the government sector was losing so many jobs. The human drama is under-appreciated. Approximately 4.9 million workers got jobs in September while 4.2 million lost jobs. That is a lot of drama for 9.1 million people in one month.

There are still 11.8 million workers on traditional unemployment and another 12 million on the new Pandemic Unemployment Assistance (PUA) for the self-employed and gig workers. For them, the clock is ticking.

Good economic data: Construction spending is up. Consumer confidence, fueled by optimism among high-income-earners, enjoyed the largest improvement in 17 years. While still below its pre-pandemic level, consumer sentiment recovered to its level in March. Retail sales have risen four straight months and is expected to increase another 4% next year. Non-defense capital goods (ex-aircraft) increased at a 33% annualized rate for July and August. New home sales rose at an annualized 4.8%, passing 1 million units for the first time since November 2006. New home construction is predicted to reach 1.35 million next year. Existing home sales also rose 2.4 percent, lifting annual sales past 6 million units, which is the highest in 14 years.

Bad economic data: The Institute of Supply Management shows the economy slowing due to the large drop in new orders. Personal income dropped 2.7% in August, when the $600 monthly top-up unemployment benefits ended. Ignoring those unemployment benefits, personal income rose 1.2%. The most recent data on industrial production dropped to 0.4% in August after growing 3.5% in July, primarily due to a slowdown in auto production and the shutdown of the oil industry during hurricane season. This slowdown in auto production also caused durable good orders to fall from a 11.7% annualized growth in July to a mere 0.4% in August.

The Congressional Budget Office decreased its long-term GDP growth projection from 1.85% to 1.60% for the next three decades, primarily due to our low fertility and decreased immigration, decreasing our total 2046 population by 10 million from earlier projections. Policy decisions have economic consequences.

The ugly deficit: For the eleven months of the last fiscal year, our government ran a stunning deficit of $3 trillion. We are expected to run trillion-dollar

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deficits through 2030. Our total national debt just passed $27 trillion and is rapidly approaching $30 trillion. The last time our debt-to-GDP ratio was this high followed World War II.

It is a waste of time to tell Republicans that tax cuts do not always stimulate the economy over the long term, just as it is a waste of time to tell Democrats that increased aggregate demand will not always stimulate the economy over the long term. The only way to get the deficit under control is to assign Republicans the responsibility to raise taxes 2% annually and to assign Democrats the responsibility to cut entitlement spending 2% annually. This is too important to rely on typical congressional grandstanding and gridlock. Business as usual simply will not work. Neither will Modern Monetary Theory, which argues deficits don't matter.

Peeking ahead: This good stock market performance has led some to describe our recovery as V-shaped, but stock market performance and the real economy are two different things. I predicted our economic recovery would look like the Nike swoosh. Without the pending disaster recovery/stimulus legislation in Congress, some are predicting an L-shaped economic recovery, which is no recovery.

Following the 31.4% collapse of GDP in the second quarter, economists expect we had 25% growth in the third and can expect mere 4.9% growth in the fourth quarter. They predict 3.6% GDP growth in 2021, down from their estimate in June, which was 4.3%.

The stock market hates uncertainty. In years of a presidential election, the market usually drifts lower as Election Day approaches, recovering quickly afterward, as uncertainty decreases. I see no reason it should be different in this year of great uncertainty.

One important source of uncertainty is the legislation for disaster relief/stimulus currently stalled in Congress. Bipartisanship began well when the pandemic struck. Unfortunately, bipartisanship was exhausted before wounded Americans could be treated. One half of America is facing a depression, not a recession.

Underwriting all this is a very accommodative Federal Reserve. They have wanted a minimum level of inflation of 2% for years, without achieving it. A little inflation is a good thing. It reduces the burden of debt. More importantly, it keeps deflation away. Deflation is a much greater problem than inflation. Eliminating inflation is much easier than eliminating deflation. Last month, the Fed said they would not react if inflation ran slightly above the 2% target, reducing any fear of higher interest rates in the foreseeable future.

Often called the "cruelest tax," inflation is not on my list of worries. However, I do worry about the unknowable long-term personal and economic costs of ending the coronavirus attack, either with or without another shutdown. Fifty-five percent of economists agree COVID-19 is the "greatest downside risk to economic growth." Is the short-term pain worth the long-term gain?

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