Growth STRATEGIES

Trend Analysis That Builds Business Decisions

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IN THIS ISSUE: RECESSION ON THE HORIZON

The US economy stumbled out of the gate in 2016 as consumers and businesses showed renewed signs of caution, underscoring the uneven growth that has been a hallmark of the nearly seven-year expansion. Gross domestic product, reports the *Wall Street Journal*, advanced at a 0.5% seasonally adjusted annualized rate in the first quarter, the worst performance in two years. Meanwhile, the next recession looms.

1 – MEDIAN INCOME, WEALTH, WAGES DOWN
2 – PROFITS DOWN = BUSINESS INVESTMENT DOWN = RECESSION
3 – EARNINGS, PROFITS COLLAPSING, 100 MILLION AMERICANS NOT EMPLOYED
4 – FINANCIAL ENGINEERING AGAIN SIGNALS CRASH
5 – FREIGHT SHIPMENTS ARE WAY DOWN
6 – RETAIL SALES AT RECESSIONARY LEVELS
7 – VELOCITY OF MONEY AT LOWEST LEVEL EVER RECORDED
8 – LONG DECLINE IN LABOR MARKET DYNAMISM
(FEWER NEW FIRMS, LOWER JOB CREATION AND DECREASED LABOR MAKRET MOBILITY)

1 – MAULDIN: MEDIAN INCOME, WEALTH, WAGES DOWN

There is a reason that large numbers of voters in both parties are frustrated. … Median income in the United States is down 8.5% since 2000. … The median net worth of US families has fallen sharply since 2007 and is roughly back to where it was 24 years ago. … Economic malaise is affecting all education groups. Even those with advanced degrees have seen their incomes stagnate since 2007. … While incomes have stagnated, the real cost of goods and services has increased much more than the purported inflation rate suggests. The cost of housing, utilities, and local taxes has certainly increased beyond inflation levels. … The bottom 90% of Americans have seen their overall income drop. Low interest rates and quantitative easing have dramatically helped the top 10%. … The financialization of America is directly responsible for this turn of events, and rather than helping GDP growth as it was intended to do, it has thwarted growth.

My basic thesis is this: Without significant changes in tax and incentive structures, the US will almost assuredly enter a recession within the next few years. Then, if we lose tax revenues only to the extent we did in the last couple of recessions, we'll be saddled with a deficit of over $1.3 trillion, and the deficit won't fall below $1 trillion as far out as the eye can see.

2 – EDWARDS: PROFITS DOWN = BUSINESS INVESTMENT DOWN = RECESSION

SocGen's Albert Edwards has discovered a "failsafe recession indicator," one which has stopped flashing amber and has turned to red: whole economy profits data, which in his own words "shows a gut-wrenching slump." Historically all recessions are effectively caused by slumps in business investment driven by a profits downturn.

Edwards believes "a recession now virtually inevitable."

3 – STOCKMAN: EARNINGS, PROFITS COLLAPSING, 100 MILLION AMERICANS NOT EMPLOYED

Analysts have been furiously marking down their estimates for Q1 for weeks now. At the latest reading profits are projected to fall by *10%*, marking the fifth straight quarter of decline.

Always and everywhere, such persistent profit collapses have signaled recession just around the corner. And there are plenty of macro-economic data points signaling just that.

For instance, total US business sales have fallen by *5.1%* since mid-2014 – even as inventories have soared. This means that while Wall Street speculators have been dancing on the edge of the volcano for 18 months, the US economy's tepid rebound has been petering out.

With *102* million adult Americans not employed and only 48 million of them retirees and spouses, it is amazing that [Fed Chairman] Yellen still has the audacity to cite the U-3 unemployment rate as indicative of anything meaningful about the state of the economy, let alone to say that it is indicative of "tremendous progress" and that the US economy is now "close to our assigned congressional goal of maximum employment." Employment in the core sectors of productivity and wealth creation — mining, energy, manufacturing and construction — has been declining since the turn of the century.

4 – RICHTER: FINANCIAL ENGINEERING AGAIN SIGNALS CRASH

Something that happened just before the prior two market crashes, and the recessions that accompanied them, including the Great Recession, is happening again: the boom in financial engineering is starting to backfire against the companies doing it.

Their credit ratings are getting slashed, and their borrowing costs are therefore rising, even while they need newly borrowed money to buy back even more shares to keep the charade going. Until the music stops.

Companies buying back their own shares, often with borrowed money, are a big force in pushing up stock prices. … When a company borrows money to buy back its own shares, the borrowed money doesn't get invested in productive activities that would help service that debt in the future. All the company ends up with is a pile of additional debt that might cause all sorts of havoc when the multi-year credit boom – the "credit cycle," as it's called – ends. And that is now happening.

5 – RAILROADS: FREIGHT SHIPMENTS ARE WAY DOWN

Many see the health of Union Pacific Railroad and BNSF Railway as indicative of the health of the overall economy, because they haul the raw materials that make the world go: food, fuel, fiber and construction materials. Low shipments from producers to processors to end users, the reasoning goes, mean low economic activity.

And freight shipments are way down — 6% lower so far in 2016 for all US railroads than at the same point in 2015.

As for how the railroads are behaving — as opposed to what some economic experts are saying about the broader economy — they already are in deep drawback on jobs: More railroad workers are on furlough, or temporary layoff, than at any time since the 2007-09 Great Recession.

6 – QUINN: RETAIL SALES AT RECESSIONARY LEVELS

The retail sales for March were disastrous and further confirmed a myriad of other economic indicators that the country is in recession.

The Ivy League-educated “expert” economists expected March retail sales to increase by 0.1%. They only missed by $6 billion, as retail sales FELL by 0.3%. They have fallen for three straight months. At least gasoline sales were strong, as prices have risen 22% since mid-February. That should do wonders for the finances of American households. If you exclude gasoline sales, retail sales fell by 0.4%.

The Fed-induced auto loan bubble is bursting, as default rates on the billions of subprime slime loans issued in the last few years skyrocket, and the prices of used cars crash as the millions of leases come due. Dealer lots are overflowing with overpriced automobiles with no demand. The implications of this bubble bursting are far reaching. The fallacious demand created by easy money kept the union manufacturing plants humming and allowed Obama to crow about saving the auto industry. As demand collapses, layoffs will surge, and the minimal profits being generated by GM, Ford, and Chrysler will turn to huge losses again.

The free fall in department store sales continues unabated, with year over year sales down 6.1%. The two retail areas which had remained strong over the last few years, restaurant sales and internet sales, both went negative in March. Their growth rates have slowed dramatically over the last three months. With year over year retail sales, excluding autos, up by a pitiful 1.3%, and real inflation for real American families up at least 5%, real retail sales are falling. That might explain the plunging retail profits.

7 – ST. LOUIS FED: VELOCITY OF MONEY AT LOWEST LEVEL EVER RECORDED

The velocity of money has declined to the lowest level ever recorded. A declining velocity of money means people and businesses are not spending or investing at full-potential levels.

In an article by an analyst at the Federal Reserve two reasons were given for this decline:

- A glooming economy after the financial crisis
- The dramatic decrease in interest rates that has forced investors to readjust their portfolios toward liquid money and away from interest-bearing assets such as government bonds

The implications of these two potential causal factors are that the Federal Reserve is in fact perpetuating the financial crisis and not solving it. The very low velocity of money which the Federal Reserve has reported for over 10 years reflects people hoarding money and not spending it.

Additionally, to stimulate demand, the federal government has been using deficit spending but, once again, to very limited effect.

Expansionary fiscal and monetary policy therefore have had little to no real effect on the economy because all other participants in the market are offsetting these expansionary efforts as reflected in the declining velocity of money.

While some may argue that the unemployment rate has declined and some other measures of economic activity have expanded, signs of deflation abound, indicating that government measures of economic progress are not reflective of what is really happening.

In particular, the unemployment rate is mitigated by the very low labor force participation

rate. The inflation rate is mitigated by those items not included in the calculation of inflation. Real disposable income has been declining or stagnant at best, which provides a contrary indicator to the unemployment rate and inflation rate.

The net effect of all of these issues is that federal government efforts at stimulating the economy through deficit spending, and the Federal Reserve's efforts at stimulating the economy through low interest rates, have been largely ineffective and perhaps counterproductive.

8 — DALLAS FED: LONG DECLINE IN LABOR MARKET DYNAMISM (FEWER NEW FIRMS, LOWER JOB CREATION AND DECREASED LABOR MARKET MOBILITY)

Despite steady job growth and a low unemployment rate, the US recovery is trailing in one key aspect: the kind of labor market dynamism that played a large role in making the country the world's economic superpower.

One telltale sign is that workers are changing jobs at a slower pace than before. Another is there's been a long decline in the number of new, innovative firms that powered job creation in the past.

Longer term, economists worry the lower turnover is an indication of stagnation, not stability: Workers are staying put because there are fewer better jobs to move to, or they face other barriers that keep them locked in their current positions. With declining job movement may come slower gains in overall employment, wages, productivity and, ultimately, economic growth.

Two other related trends point to a similar conclusion: The formation of new companies, which are relatively big generators of jobs and reflect a dynamic, forward-looking business climate, has slowed significantly over the years.

New firms, or those less than a year old, accounted for about 13% of all companies in the late 1980s, but that declined to about 8% in recent years. Making matters worse, a small but significant part of the drop-off has come from start-ups with the fastest growth and highest job creation, according to a recent paper from the National Bureau of Economic Research.

That could be one of the reasons people also aren't moving across labor markets as they once did. Census Bureau data show the annual rate at which people relocate to a different state — which is often an indicator of job changes — fell to between 1.4% and 1.7% of the overall population since the Great Recession. That contrasts to interstate migration rates at or close to 3% from 1947 through the middle of the last decade, with only a few exceptions.

Taken together, the slowdown in job-to-job movement, geographical mobility and new firm formation has economists worried the US may be losing something called "creative destruction." The term, coined by the influential economist Joseph Schumpeter in the early 20th century, describes the idea that a healthy market-driven capitalist system grows bigger and stronger because it is constantly creating better companies and products while destroying older ones that fall behind the curve of progress.

In this view, the pace of job creation and destruction has long been a hallmark of the American economic vitality. While painful for some people at some points, it produces more good in the long run. The nation's energetic and flexible labor market, compared with other countries, is considered a major reason why the US economy continued to outperform almost all others over time.

What Schumpeter called this "gale of creative destruction" has turned into something more of a breeze in the US, raising concerns about the underlying vigor and productive future of the economy.