Contraction, Contradiction, Conjecture, and Crisis *(SB News-Press)*

(July 5, 2014) Last week's news was the U.S. economy shrank by 2.9 percent during the first quarter. This has nothing to do with snowfall and cold temperatures. This is a significant CONTRACTION – an embarrassing exposure of a very weak economy. If it's reported next month that GDP dropped again during April-May-June, then back-to-back down quarters puts the U.S. officially in another recession.

But wait, the Bureau of Labor Statistics (BLS) just reported the U.S. added 288,000 jobs in June and unemployment dropped to 6.1 percent. Thursday the Dow Jones topped 17,000 and the S+P 500 flirted with the 2,000 level, as analysts expect good corporate earnings reports in the coming weeks. This is then a significant CONTRADICTION, for the economy to shrink nearly 3 percent while the employment news lifts the stock market to record highs. The new jobs report is in itself a CONTRADICTION because while 146.2 million Americans are working, 27.3 million (almost 1 in 5) only have part-time jobs, and the overall labor participation rate is under 63 percent. Even worse, the 9.47 million "officially" unemployed must be joined by another 9.7 million "unofficially" unemployed who have stopped looking for work and are no longer counted in the total labor pool, which means there are actually 19.3 million out of work from a "true" labor market total of 165.1 million workers, and that puts the BLS "true unemployment" U6 measure at a lofty 11.6 percent – nearly double the "official" rate typically quoted.

When the economy suddenly contracts unexpectedly alongside the equity markets setting new record highs, it's time for economists, analysts, and the White House to provide some interpretation about what this all means. CONJECTURE ranges from (on one end) “The 2009 Obama stimulus is finally working,” to the middle ground: “This is the typical ‘mixed bag’ of a midterm election year,” to (on the other end) “The underlying economy is weak, the stock market is an overvalued bubble, and higher interest rates, gas prices, and inflation are just around the corner.”

Let’s start with the one end of CONJECTURE regarding the $862 billion Obama “stimulus.” To somehow state that 66 months after its passage, it’s finally starting to work is complete nonsense. It was designed by the president’s economic advisors Austan Goolsbee and Christina Romer on the terribly misguided premise that greater government spending can kick-start economic growth. Based upon its short-term structure and how funds were allocated, the president’s advisors consistently forecasted that positive results would show up in 2010, then 2011, and certainly by 2012. Yet GDP growth and new employment remained weak in the aftermath of ARRA, so Romer headed back to Berkeley in 2010, and Goolsbee left for Harvard in 2011.

The Washington Post reported the stimulus was finally working when October-2011 unemployment dropped below 9 percent. A year later in August-2012, U.S. News said the “slow-release stimulus may finally be starting to have the intended result.” By 2013, the White House was so convinced that the stimulus had worked, current economic advisor Alan Krueger proposed additional federal “infrastructure stimulus.” And four months ago, President Obama announced he wants a new $302 billion stimulus to “show how we can invest in the things we need to grow and create jobs by closing unfair tax loopholes, lowering tax rates and making the system more fair.”

The middle position is an interesting way to not commit and blame everything on a midterm election year and the continued legislative stalemate in Washington, DC. So that "mixed bag" of CONTRADICTIONS includes the International Monetary Fund having just lowered its 2014 forecast of U.S. economic growth to barely 2 percent, Wharton's Jeremy Siegel expecting the Dow Jones to top 18,000 by December, while Fed Chair Yellen said on July 3rd, "Monetary policy faces significant limitations as a tool to promote financial stability" – meaning she won't raise interest rates just to curb a Wall Street bubble, even as many analysts maintain U.S. stocks are overvalued and due for a 10-to-20 percent correction.

Let's conclude with the "other end" – noting that GDP and employment news have remained weak since 2009 and no matter how you dress it up, this economy looks nothing like a recovery, because GDP, employment, federal debt, and interest rate data together align more closely with a recession than recovery. First, GDP was never close to being stimulated (barely excited), with less than 3 percent annual growth (compounded quarterly) from 2009 thru today. I continue to maintain that the U.S. economy is missing $2 trillion of higher GDP it should have added since 2009, had federal spending been held to Bush-era levels, taxes been reduced across-the-board, and almost a trillion dollars had not been wasted on the Obama stimulus. Second, I've been commenting for 4 years that the economy needs to add 350,000 per month for 3 years to get "true" unemployment back to 5 percent. Even if we drop all of Obama's 2009 jobs data as residual recession effects, total new jobs from January 2010 to June 2014 are just 5.6 million – a monthly average of only 102,000.

Finally, the federal debt will hit $18 trillion by the end of 2014, requiring $223 billion of interest (an average 1.2 percent on T-bills, T-notes, and T-bonds). When the Fed allows rates to return to true market-levels of around 4.5 percent, interest on the debt will grow to almost $850 billion and consume more than 23 percent of all federal spending. Two weeks ago, Standard + Poor's maintained its AA+ debt rating on the U.S., choosing <u>not</u> to return the top AAA rating. Interest on auto and home loans, credit cards, and all business borrowing – including corporate bond yields – will also go up as much as three-fold. That will translate to lower consumer spending, a decline in future corporate earnings, the continued devaluation of the U.S. dollar, and higher inflation – with oil prices projected to top $5.00 a gallon in California in 2015. Taken together, that's a CRISIS. Sad to say, these numbers are all in line with my 2012 book's projections of where we'd be in 2014, which means it's pure White House CONJECTURE that this is a sustainable recovery.