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# The Equivocal Economy

*by Patrick J. O'Keefe, Director of Economic Research*

Adolescents often rely on "yeah-but" equivocations to explain the complexities of reality. (For example: "Yeah-but I wouldn't have been late if I wasn't stopped for speeding.")

In light of the erratic behavior of the economy since the end of the "Great Recession" we should name the rebound the *"Yeah-But Recovery"* ("YBR") as in: "Yeah-but it's not as bad as it was," and "Yeah-but it's not as good as it should be."

Federal Reserve Chair Ben Bernanke best summarized the implications of the YBR when he testified that "the economic outlook remains unusually uncertain."

This has been a YBR from the start. Its beginning wasn't announced until 15 months after the event by the National Bureau of Economic Research ("NBER"), in what was tantamount to a yeah-but release (cf., http://www.nber.org/cycles/sept2010.html).

In making its determinations, the NBER examines a range of "measures that refer to the total economy," including Gross Domestic Product ("GDP"), data on incomes and wholesale/retail sales, and indicators of output. Its determinations are not based on a "fixed formula;" but are, instead, an informed judgment of when the shift from contraction to growth *(or vice versa)* occurred.

So now, some 30 months after the recession "officially" ended, has the economy yet **recovered**, based on the NBER's criteria? That is: has it returned to pre-recession levels?

The answer is a resoundingly equivocal: "Yeah-but...."

On the broadest measure of activity, real GDP (i.e., total output adjusted for inflation), the economy ended 2011 *(chart 1)* just above where it stood at the end of 2007. So if GDP were the only measure of the economy's health, we would declare its recovery to be complete… if only by a cat's whisker.

Yeah-but on other key indicators the economy either: remains below pre-recession levels [e.g., employment conditions *(chart 2)* and industrial production *(chart 3)*; or, like retail sales *(chart 4)*, has surpassed them only because of inflation *(chart 5)*].

Yeah-but aren't after-tax incomes, even when adjusted for inflation almost $1 trillion more than prior to the downturn? Yeah-but not because more workers are earning more, but largely because income transfers are up and taxes down *(chart 6)*.

Indeed, wage and salary disbursements *(chart 7)* (i.e., dollars in paychecks) were only 57.4% of after-tax incomes in 2011, essentially unchanged from 2010's record low (57.3%).

When adjusted for inflation, however, disbursements *(chart 8)* are 4.2% below where they were in December 2007. That is to say: working households' purchasing power has yet to recover.

The yeah-but character of the recovery has contributed to its sluggish pace and stutter-step progress. Early on, it restrained household confidence *(chart 9)*; and then, mid-2011, caused it to falter.

Since then, however, the consumer's outlook has improved robustly as job growth *(chart 10)* began to accelerate. During the six months through January, confidence rose more than in any other six-month period since March 1991. Yet, despite that, it remains weak.

Similarly, after sliding downward for much of 2011, business confidence *(chart 11)* rose smartly in the final quarter. The outlook is for activity to improve at least through the summer.

Which brings us to the outlook for the remainder of the year, beginning with the question: does heightened confidence among businesses and households imply that the economy is shifting from a yeah-but to a no-but recovery?

The answer is: Yeah-but, equivocally.

One reason for equivocation is that U.S. exports will slow due to the financial turmoil and recession in the Eurozone and slower growth in emerging economies. Another is the drag arising from fiscal consolidation domestically. Yeah-but what about consumer spending, which comprises about 70% of GDP? Won't rising employment translate into more spending by households?

Yeah-but over the past year consumer spending has increased more rapidly than after-tax incomes, while savings have declined. And households have become much more judicious in their use of credit *(chart 12)*: keeping credit-card balances low, while borrowing for cars and student loans. Consumer spending will grow, but only in line with nominal after-tax incomes.

And despite the improvements in employment, incomes, and sentiment, there is little prospect of a rebound in housing activity. Instead, given that homeowner equity is less than one-half its 2007 peak, housing will continue to constrain consumer spending.

Yeah-but with corporate profits *(chart 13)* at record levels and businesses feeling optimistic, won't they invest more?

Yeah-but a considerable share of those profits were earned outside of the U.S. and would be subject to additional taxes before they could be spent or invested domestically. Nevertheless, some increase is expected in business investments in plant, equipment, software, and inventory, which have been a mainstay of the recovery *(chart 14)*. But in absolute dollars, the boost will be limited.

## Outlook

The view here has long been—and remains—that the economy would recover only slowly from the 2007-2008 recession and the coincident meltdowns in the financial and housing sectors.

Over the past few months, several indicators—most notably those relating to labor markets—have seen a modest increase in momentum. That is certainly positive and looks likely to continue into the second half of the year.

Yeah-but, what lies beyond the fourth quarter, when national elections occur and the temporary fixes that pass for Federal fiscal policy expire? There we stand with Mr. Bernanke: "the economic outlook remains unusually uncertain." But, we do so equivocally. ■

*Accompanying charts appear on the following pages.*

*Patrick J. O'Keefe is director of economic research at J.H. Cohn. He can be reached at pokeefe@jhcohn.com or 1-877-704-3500. For more insight from Mr. O'Keefe, please visit our website, www.jhcohn.com.*

## CALIFORNIA

**Los Angeles**
11755 Wilshire Boulevard
17th Floor
Los Angeles, CA 90025
310-477-3722

**San Diego**
9255 Towne Centre Drive
Suite 250
San Diego, CA 92121
858-535-2000

**Warner Center**
21700 Oxnard Street
7th Floor
Woodland Hills, CA 91367
818-205-2600

## CAYMAN ISLANDS

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

## CONNECTICUT

**Glastonbury**
180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

**Farmington**
76 Batterson Park Road
Farmington, CT 06032
860-678-6000

**New London**
125 Eugene O'Neill Drive
Suite 120
New London, CT 06320
860-442-4373

**Stamford**
1177 Summer Street
Stamford, CT 06905
203-399-1900

## MASSACHUSETTS

**Springfield**
One Monarch Place
Suite 2020
Springfield, MA 01144
413-233-2300

## NEW JERSEY

**Roseland**
4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

**Eatontown**
27 Christopher Way
Eatontown, NJ 07724
732-578-0700

**Metro Park**
333 Thornall Street
Edison, NJ 08837
732-549-0700

**Princeton**
103 Carnegie Center
Suite 311
Princeton, NJ 08540
609-896-1221

## NEW YORK

**Manhattan**
1212 Avenue of the Americas
New York, NY 10036
212-297-0400

**Long Island**
100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

**White Plains**
1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700

J.H. COHN LLP
ACCOUNTANTS & CONSULTANTS

**877-704-3500**
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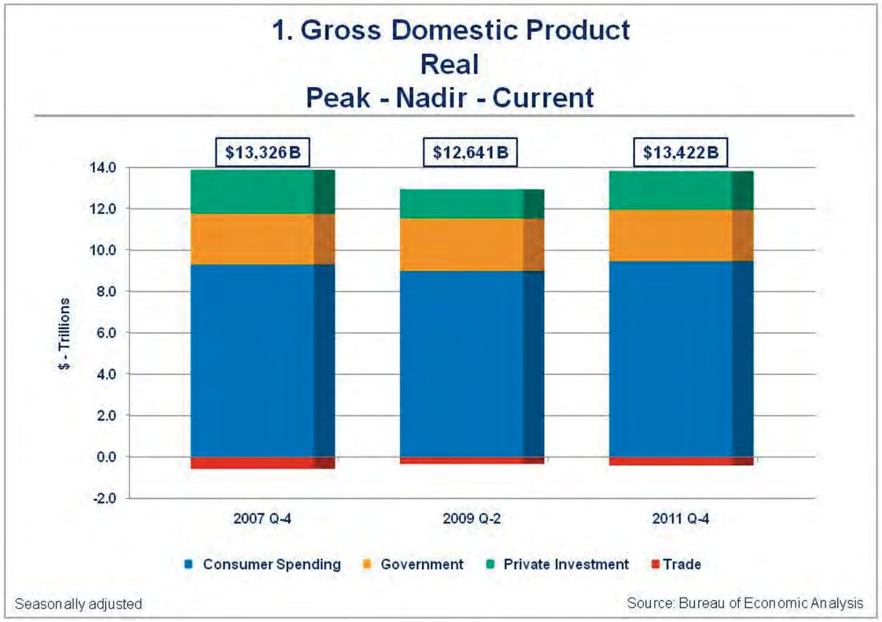
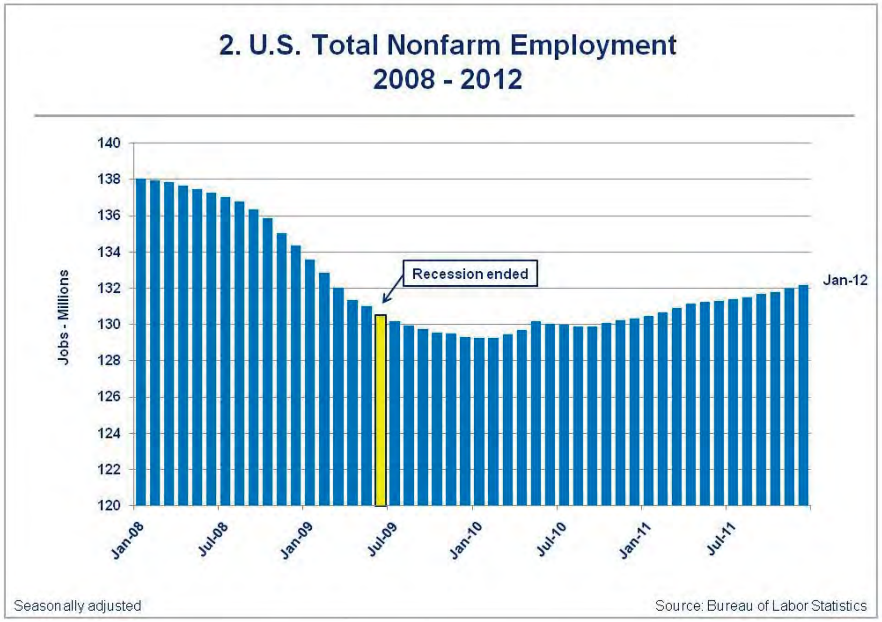
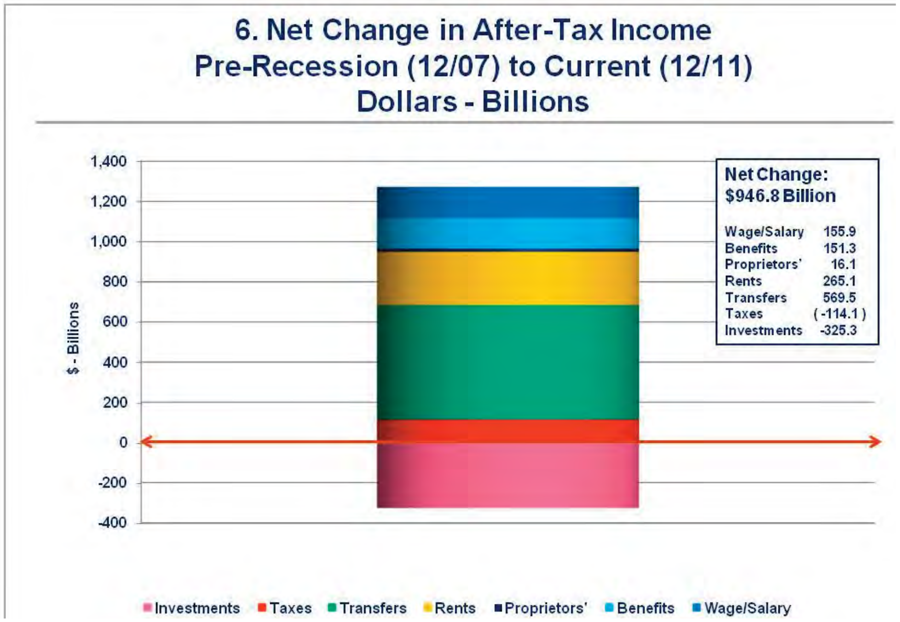


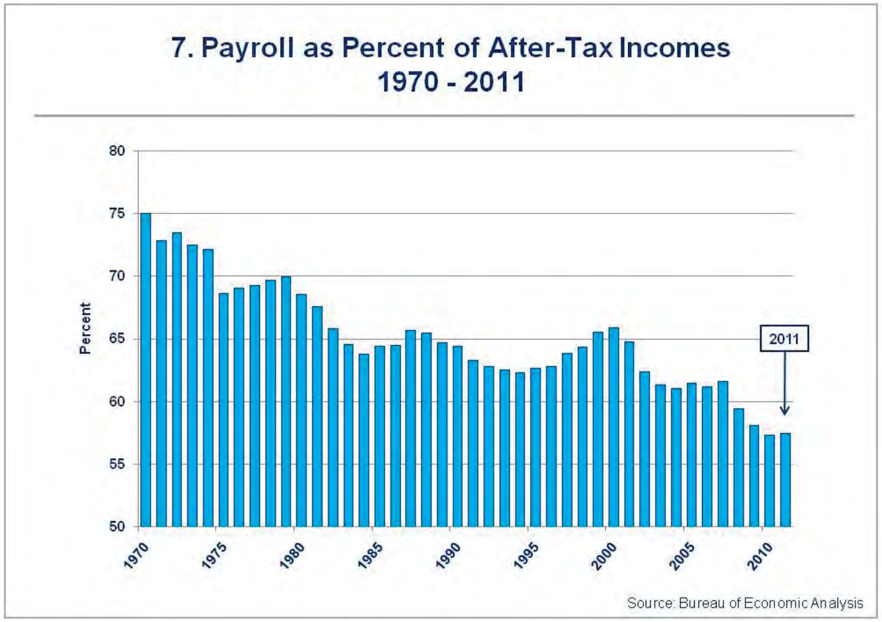





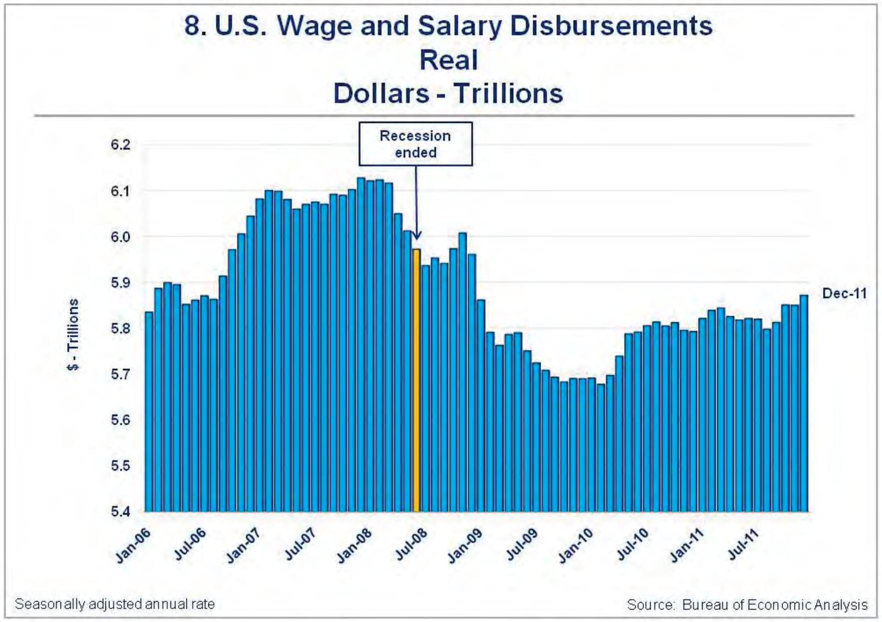
5. U.S. Retail Sales - Real
Dollars - Billions
2007 - 2011
330
320
310
300
290
280
270
260
250
240
$ - Billions
Dec-11
Jan-07
Jan-08
Jan-09
Jan-10
Jan-11
Market based PCE deflator (2005=100); seasonally adjusted
Sources: Census Bureau and Bureau of Economic Analysis

6. Net Change in After-Tax Income
Pre-Recession (12/07) to Current (12/11)
Dollars - Billions
1,400
1,200
1,000
800
600
400
200
0
-200
-400
$ - Billions
Net Change:
$946.8 Billion
Wage/Salary 155.9
Benefits 151.3
Proprietors' 16.1
Rents 265.1
Transfers 569.5
Taxes (-114.1)
Investments -325.3
Investments
Taxes
Transfers
Rents
Proprietors'
Benefits
Wage/Salary

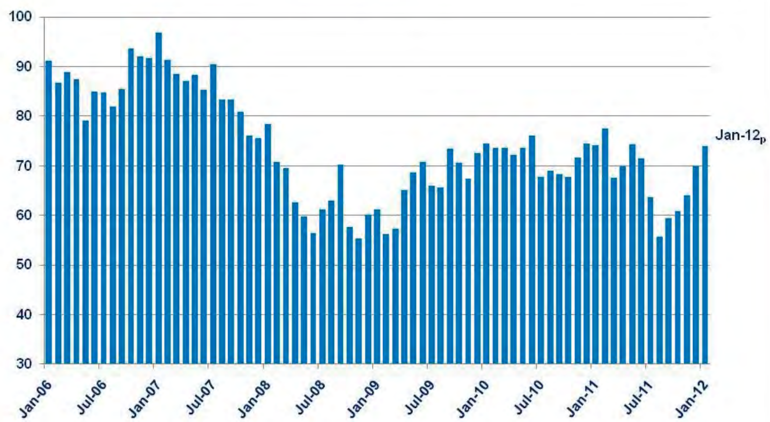



7. Payroll as Percent of After-Tax Incomes
1970 - 2011
80
75
70
65
60
55
50
Percent
2011
1970
1975
1980
1985
1990
1995
2000
2005
2010
Source: Bureau of Economic Analysis

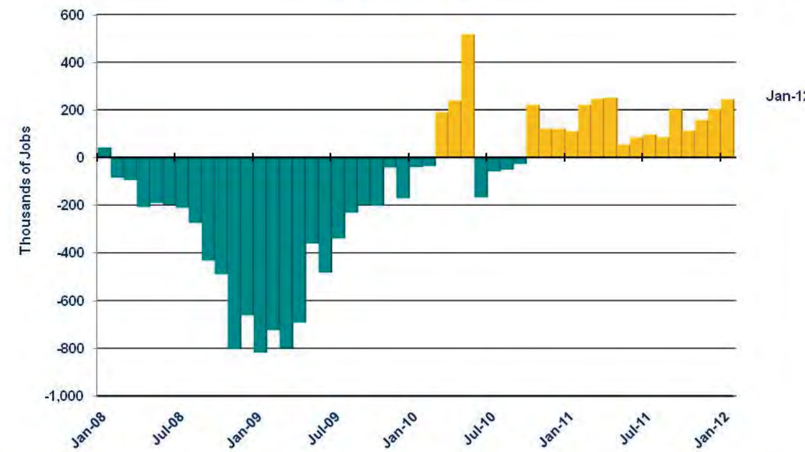
8. U.S. Wage and Salary Disbursements
Real
Dollars - Trillions
Recession ended
6.2
6.1
6.0
5.9
5.8
5.7
5.6
5.5
5.4
$ - Trillions
Dec-11
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
Jan-09
Jul-09
Jan-10
Jul-10
Jan-11
Jul-11
Seasonally adjusted annual rate
Source: Bureau of Economic Analysis

### 9. Consumer Sentiment Index
### Thomson Reuters/Michigan University
### 2006 - 2012




Source: Reuters/University of Michigan

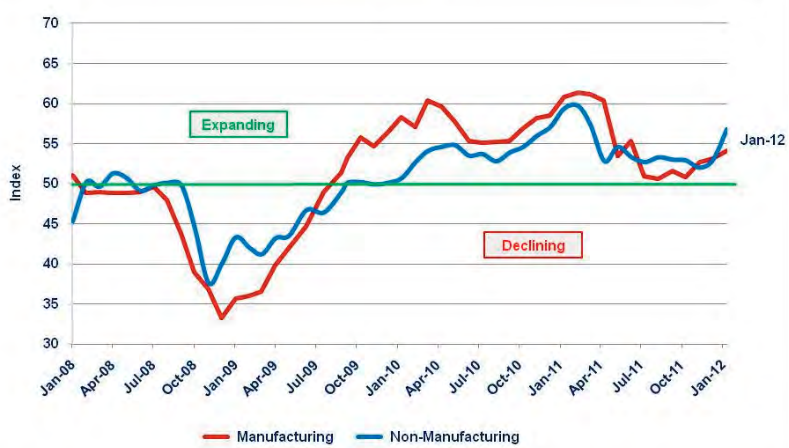
### 10. U.S. Total Nonfarm Employment
### Monthly Changes
### 2008 - 2012




Seasonally adjusted

Source: Bureau of Labor Statistics

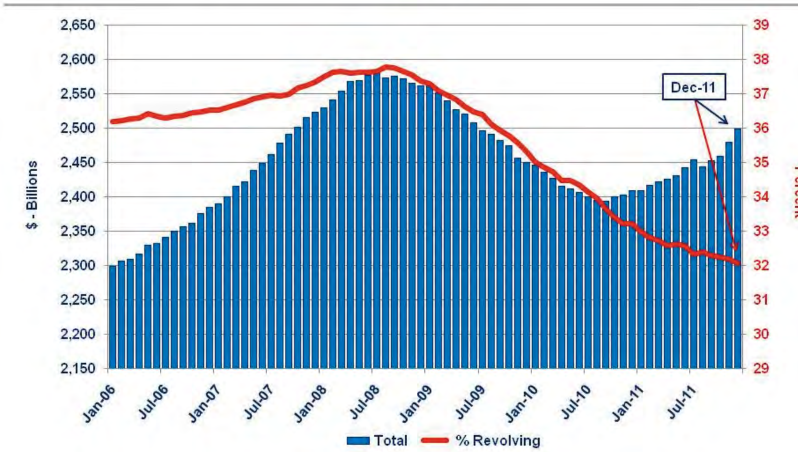
### 11. ISM Manufacturing and Non-Manufacturing Indexes
### 2008 - 2011




Seasonally adjusted

Source: Institute for Supply Management

### 12. U.S. Consumer Credit Outstanding
### 2006 - 2011




Seasonally adjusted

Source: Bureau of Economic Analysis

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