



L. R. Levin Consulting, L.L.C.

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Merry Christmas

Is The Conflicting Economic Data Confusing Or Really Consistent?

In recent weeks there has been a flood of economic data either pointing toward a faltering recovery or toward a continuing strengthening of the recovery. This data has led to inconsistent news reports depending on what data was released that day.

The Wall Street Journal headlined, “Jobs Setback Clouds Recovery.” Confused, the Journal mused, “a surprisingly weak jobs report cast a shadow over the economy, undermining several weeks of positive data and diluting hopes of an accelerating recovery.”

The confusion in the news media has merely mirrored inconsistent discourse by consensus economists each time an item pointing in an opposing direction is released. For ex-

ample, a recently released key leading indicator, the Purchasing Managers Index, was up for November. This caused many consensus economists and the Journal to talk about the strengthening recovery.

But shortly after the Purchasing Managers Index came the unemployment figures. Basic unemployment rose from 9.6% to 9.8%. Real unemployment rose from 17.12% to 17.26% meaning 26.6 million American’s are unemployed. As we will discuss later in this article, several factors in the unemployment report demonstrated the weak, fragile pace of the “recovery.”

The continual release of conflicting data has confused many including the media on where the economy is headed. It raised the question, *is there a problem with the economic data?* The short answer is “no.”

The problem is misplaced expectations, both by consensus economists and reporters. It is the natural confusion caused by loose terminolo-

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gy and ideological economic philosophy. *What does that mean in simple terms, you ask?*

Reality based economics is the application of proven fundamental economic principals. The law of supply and demand is an example. If demand rises as compared to supply, the item becomes relatively scarcer, and the price rises. If supply rises as compared to demand, the item becomes more plentiful, and the price falls.

These are time tested facts or principals. The effect of relative changes in supply and demand does not change irrespective of whether an economist is a conservative or liberal economist. However, what certain economists expect to happen under varying condition can be influenced by their ideology. Tax policy, for example, often falls prey to this problem.

So when we say the confusion is caused by loose terminology and ideological economic philosophy what do we mean? We mean that when we are in a “recovery,” we expect all aspects of the economy to be getting better in a fairly brisk manor. Similarly, “liberal” economists be-

lieve Fed Chair Bernanke when he says we are not printing money, we are buying bonds.

So they interpret an improved purchasing managers index as an across the board strengthening of the economy. Thus, economic ideologues fashion their own use of terms, like “recovery” coupled with a simple interpretation of economic data like the purchasing managers index, into an expectation that the broader economy is getting rapidly better.

Looking back, over a year ago we predicted, based on government policy continuing unchecked, that 2010 would see a technical recovery that would continue at a slowing pace into 2011. We described it as an “H” shaped recovery. ([Click Here To Read Our Managing For Success Article On An "H" Shaped Recovery and What It Means For You.](#))

This was based on fundamental economic principals. *At this phase of the economic cycle in an “H” shaped recovery, what should we expect?*

We would expect that the economy has hit bottom and then plateaued. Given the government’s policies we would also expect that the “recovery” would be in a very narrow

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range and at a very slow rate of increase.

Realistically the economy has been downsized in many respects by about 20% from where it was functioning before the recession began. We would expect the businesses that survived to have resized their operations to a point where they can operate profitably at current relatively low demand levels.

This type of transition changes buying patterns as well as “go to market” strategies. We would also expect that such severe resizing would create major long term unemployment, real estate, and manufacturing problems, among others. This type of recovery, absent a substantial shift in government policy, creates and perpetuates growing fundamental disconnects in our economic free market economy.

Viewed from this perspective, the conflicting economic data of the last few months should not be confusing, but rather consistent with what we should expect! Take the purchasing managers index (“PMI”) for example.

The PMI was above 50 which indicated that the manufacturing sector would continue to expand from

where we were well into the first 6 months of 2011. Driving this number was the growth in supplier deliveries, a buildup in manufacturers’ inventories, and an increase in imports of materials by manufacturers in November.

The problem is that the recession was so deep that slight increases in these numbers really only demonstrate a change in direction not a return to what we would consider normal for our economy. An increase in supplier deliveries reflects preparation for modest Christmas sales, as does a buildup in manufacturers’ inventories. The modest increase in imports of materials by manufacturers in November merely reflects how little we make in this country today and how reliant we have become on foreign sources.

Without a substantial increase in employment, the level of demand for domestically manufactured goods will not return us to the pre-recession level of activity needed to sustain a good, growing economy.

Even more importantly are PMI factors not discussed by the media and the consensus economists. The report showed declines in new orders, production, and exports all of which

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partially offset the impact of the positive factors discussed above. Even more critical, the survey respondents reported that rising material costs are eroding profit margins as we head into 2011.

The Fed's quantitative easing is beginning to have a negative effect that will retard the recovery. Thus, on closer examination the "good news" of the PMI is consistent with an economic recovery where the "have nots" of the "H" shaped recovery continue to erode America's basic economic structure. The size of the increases are too small to represent a significant improvement in where we are in the cycle. The news reports should have been focused on how weak our recovery is, not that we are recovering.

In this perspective, the latest poor unemployment numbers are completely consistent with the "good news" the consensus economists and media were reporting. With the growth in the economy so slight we are not able to significantly improve the level of employment. The number of people who have been out of work over a year is greater than in any recession since World War II. Until this situation changes and we see sub-

stantial growth in private sector employment, the "recovery" will not restore good economic health.

In November, once again, temporary help services lead the way creating 40,000 new jobs. This meant that aggregate job growth in all other categories combined was negative resulting in a total increase of only 39,000 new jobs. The strong showing of temporary help services growth compared to all other categories reflects the reluctance of private sector employers to create new permanent jobs given the lack of sustainable increasing demand for goods and services.

Since September 2009, temporary help services have added 494,000 new jobs. Manufacturing employment has been relatively flat since May 2010, losing 13,000 jobs in November. This is particularly important since it is manufacturing that has been leading the way out of the recession.

In fact, the average workweek for production and nonsupervisory employees on private nonfarm payrolls decreased by 0.1 hour to 33.5 hours in November. Even with an increase in manufacturing, the average

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hours work by manufacturing employees remained unchanged at 40.3 hours. To put the recovery in perspective nonfarm payrolls need to increase at 10 times the current rate for the U.S. to see a meaningful recovery underway! While consensus economists were pleased with this past week's announcement that the number of initial claims for unemployment insurance were down to 421,000, a decrease of 17,000 from the previous week, this is far from a good report.

All of this data is consistent with an economy that has dropped materially and hit bottom. The economic cycle is now in a steady slow climb. It is a little like the person who falls in a swimming pool and sinks 12 feet, hitting the bottom. The fact that the person has bounced up 10 inches off the bottom still leaves them 11 feet 2 inches short of being able to breathe.

For those with jobs, stability means they can return to doing more of what they were able to do before. For 26 million unemployed, they are still in a depression. The idea that in 6 to 8 years they may see help is not

the target that our economy should aim to achieve.

Will The Proposed Tax Cuts Avoid A Recession In 2014?

Congress is now debating whether to extend the Bush tax brackets or raise income taxes in 2011. We have heard much about the compromise reached between the President and Republicans. However, the current news reports sound too much like the old Washington nonsense all over again.

The house is focused on how to stop the compromise and take things away from the "rich." The Senate wants Santa to come early and is trying to add "goodies" for everyone. The President has predicted disaster if it all passes, and alternately, if it doesn't pass, depending on which day's newspaper you read.

All of this may be good theater or politics, but it is terrible economics. Our strategic partner, the Institute for Trend Research, has predicted "a probable recession in 2014 and a probable Great Depression beginning sometime around 2030."

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[\(Click Here To See Our Article On “Are We Headed Toward Another Great Depression?” in the July 2010 Newsletter.\)](#)

The government should be totally focused on how best to create jobs and a business friendly environment that will change the course of the economic cycle *avoiding* both the possible recession in 2014 and the great depression to follow.

In economics, you cannot effectively separate the short run from the long run. John Maynard Keynes said we all die in the long run. So far, on this he was right.

The real lesson is that what you do in the short run effects what happens in the long run. Thus, if we are to avoid another recession in the near term, we must do the things that will really strengthen the economy now. But, we must do them in a way that also strengthens the economy in the long run, or we will surely pay for it dearly in the future.

Like good action step strategic planning, the government should be focused first on what will strengthen our economy in the long run and avoid a great depression by 2030. With this in mind, the government can

work on strengthening the economy in the short run without hurting the economy as time goes on.

To strengthen our recovery we must convert the “H” shaped recovery into a “V” shaped recovery. That requires private sector job creation. It also requires a true commitment to a free market economy. If a major portion of the U.S. population cannot find work, that dislocation will severely hurt the economy, both in the short and in the long run.

The current political problem is that to achieve a strong long term economy, two critical things must occur: 1) We must reduce taxes across the board and 2) substantially reduce the deficit. In short, history (reality based economics) teaches that if we reduce taxes across the board we increase economic activity. With that, in the long term, we increase revenues and reduce deficits. [\(Click Here To Read Our **Managing For Success Article On Broad Based Tax Cuts As The Right Type Of Stimulus.**\)](#)

Under current circumstances this creates a painful choice. The government must reduce taxes and at the same time substantially reduce spending. The current debate in Con-

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gress and the executive branch have little correlation to these goals.

Is what has been proposed by the President and Congress good or bad for the economy? Extending the current tax brackets does not cut taxes and infuse added liquidity into the economy. If all else remains equal, all it does is prevent the material injury a tax increase would cause in 2011 and beyond.

Extending all of the current tax brackets is neutral, but is critical to our long term economic health. The upper bracket taxpayers include many pass through entities that provide millions of jobs. Any current increase on these brackets would hurt employment.

All of the brackets should be extended. It would be better if this were permanent or for at least 5 years. There are many tax increases beyond the current brackets, scheduled to go into effect in 2011 through 2014 and these should be repealed or stopped, if we want to strengthen the economy.

Similarly to maintaining the brackets at current levels, the proposed extension of the college tuition credit, continued exemption of 22 million taxpayers from the alternative

minimum tax, extension of plant and equipment investment deduction and research and development credits all prevent tax increases that would have drained liquidity out of the economy.

The increase in the estate tax from the current 0% to 35% (although less than the old 55% of 10 years ago) threatens to force many family businesses and farms to be sold to pay taxes, hurting jobs. Again, private sector jobs should be our number 1 priority right now.

The one year 2% reduction of the employee's share of the social security payroll tax is a small short step toward tax reduction and adding liquidity to the economy, as is the expansion of the \$1,000 child tax credit to more families.

While taken together, all these prevent further strong imminent negative impacts on the economy, they fail to address the very real structural needs of the economy. The "President's compromise" is a limited step in the right direction. Economists see it as improving growth in 2011 because they had forecast less growth based on the expected tax increases.

Extending jobless benefits is a mixed blessing. While it helps some,

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it does not create jobs. Many economist believe extensions only adds to unemployment. *Given the nature of the compromise how is the old Congress responding?*

The House has utterly failed to rise to the occasion. The Senate's attempt to treat the bracket extension as an opportunity to add other items that pay off favored political friends is a complete disservice to the nation.

To avoid a recession or even worse a depression, the new Congress must turn its attention to cutting spending. This is where the biggest challenge lies. In the past 2 years, nondefense departmental spending has risen by 25%! Cutting taxes and spending is critical.

An even bigger challenge is posed by state and local governments. State and local governments have been raising their taxes and fees materially, draining liquidity

out of the economy. This has happened in spite of receiving substantial federal subsidies.

There is no question that by shifting a substantial portion of their borrowing to the federal government, many states have thus far avoided bankruptcy. Like the fiscally irresponsible Euro Zone countries, as the federal government's deficits force it to stop underwriting bad state and local financial practices, this will change. If we are to avoid a future collapse of our economy, local, state, and federal governments must adopt a new approach to what they can provide.

So, will the proposed tax cuts avoid a recession in 2014? The answer to our opening question, therefore, is no. The proposed tax cuts by themselves won't avoid a recession in 2014. To avoid economic dislocation going forward, the federal government needs a very different approach to both short term and long term economic policy.

Recent Cartoon



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