Armchair Economics

Perspectives from an everyman for the everyman

The Melancholy Economy

March 2010

Wall Street says profits are beating expectations. Credit markets have improved, with high yield issues leading the charge. Investment grade bank loans are oversubscribed. Unemployment dipped below 10%. The stock market is up significantly from its low a year ago. Some economic indicators suggest we're out of the "Great Recession". But as a good friend said the other day, "Things may seem better, but they just don't feel right".

Everyone asks me the same question, "How's the job market, Doug? I hear it's improving."

"Well, a year ago we had several projects under execution and today we do as well. I can't tell you if things are improving, they sort of feel about the same. What we need is more business creation, new entity creation. Every new entity needs to staff up. Those jobs need filling. Then the holes left open by folks that took those jobs need to be refilled. We're not seeing much new entity creation at all."

"Why's that Doug? Do we just need the banks to start lending more to small business? Won't that inspire more new entity creation?"

"That will help, but mostly we need to remove all the uncertainties in the global and domestic economic environment. "

"What uncertainties are you talking about, Doug?' Here's a list….

Unemployment…health care "reform"…financial industry re-regulation…carbon policy "reform" and climate change debate…Greek debt and Euro fragility…Japan debt…US Federal, State and Municipal debt…commercial real estate debt…foreclosures and home sales…Chinese economic policy…creeping protectionism…Iranian and Israeli tension…oil and commodity prices…potential inflation…existing asset deflation.

Expect I am missing something here but all around us seems to be both "event risk" as well as turnaround sustainability risk. Maybe we've seen a reduction in total implosion risk but there still seems to be lots of risk surrounding our economic situation. What happens if the EU implodes? What happens if foreigners quit buying US debt? What happens if Iran gets nuclear weapons capability? What happens if…?

All this uncertainty makes longer term planning, investing and lending a challenge. Until we find more certainty, more confidence in the future, it is going to be difficult to find a sustainable economic turnaround. In the end though, just greater confidence may not be the solution. What we need is some kind of catalyst to inspire economic growth. Just look at the last three decades. Each had their catalysts.

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In the 1980's collapsing oil prices, interest rates and inflation inspired economic growth. The deregulation of Savings & Loans helped inspire a commercial real estate boom. Financial innovation began with the junk bond and securitization markets. Money "grew". Markets boomed. All this led to a recession inspired by the Latin American debt crisis and commercial real estate bust. We lost numerous large commercial banks. Even Citibank almost went under. The end of the 80's though saw the beginning of a massive technology boom. Seeds for that boom had already been planted.

The 1990's were an amazing economic decade. Moore's Law ruled! Proliferation of PC's, the Internet, cell phones, plus Y2K fear inspired massive new investment and reinvestment in technology. That decade saw deregulation in telecommunications, media, natural gas, power and financial services. We bought PC's. We went from free TV to pay cable. We bought cell phones and signed contracts. We signed up for Internet access. And globalization gained significant momentum as America started buying all kinds of stuff…new stuff and upgraded old stuff. It all ended in the equity market bust. Not long after came 9/11. But then accommodative monetary policy and financial "innovation" really kicked in.

Obscenely low interest rates combined with financial "innovation" inspired an explosion of money in the 2000's, leading to booms in real estate, consumption and alternative investing. People went from a Kenmore to a Viking, from a Maytag to an LG, from a Toyota to a Lexus. Fueled by American consumption, globalization gained hyper momentum. Inflation remained low as cheap labor replaced expensive labor in the production of goods. Money was everywhere and cheap. To be considered middle class you almost had to own a second home on the beach or in the mountains. If you didn't have a McMansion you were obviously a slow learner.

So now what? Where do we go from here? What's the economic catalyst for this decade?

Interest rates can't get much lower. Reigning in financial "innovation" leads to less money sloshing around for consumption and investment. It seems we've already "deregulated" every possible industry. Now it's time to increase regulation…and taxes…which increases the cost of doing business and the cost of living. Technology today isn't inspiring as much new consumption as it is inspiring productivity increases…fewer man hours needed for the same output…read…fewer jobs.

So we're living in this world of uncertainty. Too many risks are in place to take us from the feeling of fragility to confidence. There seems no catalyst to propel us forward. So we sit on our hands and sit on our money. "Things may seem better, but they just don't feel right".

Doug

Douglas A. Leyendecker
713-862-3030
doug@armchaireco.com