Rampant Unemployment: Slip-sliding into Recession

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In June, the Fed's bond buying binge (QE2) will end and the economy will have to muddle through on its own. And, that's going to be tough-sledding, because QE2 provided a $600 billion drip-feed to ailing markets which helped to lift the S&P 500 12% from the time the program kicked off in November 2010. Absent the additional monetary easing, the big banks and brokerages will have to rely on low interest rates alone while facing a chilly investment climate where belt-tightening and hairshirts are all-the-rage and where consumers are still licking their wounds from the Great Recession. None of this bodes well for the markets or for the millions of jobless workers who continue to fall off the unemployment rolls only to find that the social safety net has been sold to pay off the mushrooming budget deficits.

So, what are the odds that the economy will tumble back into recession?

First, let's look at the stock market and an article by Marketwatch's Mark Hulbert:

"There have been only four other occasions over the last century when equity valuations were as high as they are now, according to a variant of the price-earnings ratio that has a wide following in academic circles. Stocks on each of those four occasions would soon suffer big declines….

The four previous occasions over the last 100 years that saw the CAPE as high as they are now:

The late 1920s, right before the 1929 stock market crash

The mid-1960s, prior to the 16-year period in which the Dow went nowhere in nominal terms and was decimated in inflation-adjusted terms

The late 1990s, just prior to the popping of the internet bubble

The period leading up to the October 2007 stock market high, just prior to the Great Recession and associated credit crunch

To be sure, a conclusion based on a sample containing just four events cannot be conclusive from a statistical point of view. Still, it will be hard to argue that the current stock market is undervalued or even fairly valued…." ("History bodes ill for stock market," Mark Hulbert, Marketwatch)

Well, that doesn't sound too good, does it? The markets appear to be at a tipping point while consumers are still deleveraging to get out of the red. But at least another credit expansion is underway, right? Isn't that what Bernanke just said two weeks ago? That's should keep the economic-flywheel spinning-along until consumer demand picks up, right?

Ahhh, if it was only true. But, it's not. There is no credit expansion; it's just more public relations fluff like "green shoots" and "self sustaining recovery". Here's a blurp from Gluskin Sheff's chief economist David Rosenberg who breaks down in the credit picture in plain English:

"Consider this: We know that consumer credit, ex-student loans, is still contracting. And we know from National Federation of Independent Business that "the vast majority of small businesses (93 percent) reported that all their credit needs were met or that they were not interested in borrowing."…

And this—also from The Big Picture blogsite:

"The new U.S. consumer credit numbers reflect an economy that is reaccelerating, and that is very bullish for growth – as well as inflation. All in all, U.S. household credit surged by $7.62 billion in February, ramping up faster than at any other time since June 2008.

I respectfully beg to differ. While the story gives a passing nod to the rise in student loans, the fact of the matter is that student loans are virtually the whole story, and the downward trend/trajectory in credit, save that category, has really not reversed." ("Fade the Consumer Credit Headline", The Big Picture)

Sure, student loans and subprime auto loans have been surging, but that's mainly due to crafty sales-hype and government subsidies rather than real organic demand. The truth is, consumers are still hunkered down and adding to their savings. They're shunning additional debt regardless of low rates and other inducements. So demand is still weak and getting weaker as food and energy prices soar. And, while its true that core inflation is still hovering around 1%, headline inflation has zoomed to 0.5% in the last month alone. What does it mean? It means that the average working slob can't buy Mom that new waffle-iron because he shot the wad filling his behemoth SUV with CITCO unleaded.

It's the same for retail sales, which increased by a whopping 0.4% in March. Only, don't drill too far into the numbers or you'll find the truth, that apres gasoline, the number drops to a paltry 0.1%, hardly worth mentioning. So, times are tough for consumers and they're about to get a lot tougher as the GOP-led Congress takes its meatcleaver to the 2012 budget and the states are forced to dump payrolls and slash services to the poor and needy. It's all bad.

Is it any wonder why small business owners are so dejected and don't see a glimmer of light anywhere? Check out this article from the Wall Street Journal:

Small business owners became more worried about the economy in March, according to data released Tuesday….The National Federation of Independent Business's small-business optimism index fell 2.6 points to 91.9 in March….

Despite worries about future demand, small business owners plan to increase their selling prices. The report said the seasonally adjusted net percentage of owners reporting higher selling prices increased to 9% in March, from 5% in February. The reading has risen 20 percentage points since last September, the report said.

The NFIB said a major force behind the price increases is the elimination of excess inventories. The report also said profits are "badly in need of some price support."….

The increased pessimism among small business owners in March echoes more downbeat views among U.S. consumers that showed up in two major surveys of household attitudes last month. ("Small-Business Optimism Declines", Wall Street Journal)

Not only are small business owners feeling depressed, but consumer confidence is plunging as well. This is from Gallup:

"Americans' optimism about the future direction of the U.S. economy plunged in March for the second month in a row, as the percentage of Americans saying the economy is "getting better" fell to 33% — down from 41% in January.

Economic Optimism Declines Across Demographic Groups

While upper-income Americans remain more optimistic than their lower- and middle-income counterparts, optimism among both groups declined substantially in March. Despite Wall Street's strong first quarter performance, the percentage of upper-income Americans saying the economy is getting better fell to 41% in March from 50% in January, leaving it at the same level as a year ago. Lower- and middle-income Americans' economic optimism also fell in March, to 32%, from 40% in January….

Gallup's Economic Confidence Index Also Takes a Plunge in March….

…American consumers face several major challenges. Soaring gas and food prices not only reduce disposable income but also discourage additional spending as the cost of necessities increases. Global events, continued political battles about the budget in the nation's capital, and a weak, if modestly improving job market add to consumer uncertainties. As a result, it is not surprising that consumer confidence plummets even as Wall Street continues to do well.

However, if consumers continue to lack confidence and spending doesn't increase, it is hard to see how the U.S. economy can continue its modest improvement…" ("U.S. Economic Optimism Plummets in March", Gallup)

So, yes, the rich and well-heeled are feeling quite good about things of late, but the rest of us are in a constant state of near-panic just trying to figure out how we're going to keep the wolves away from the door. That may explain why–after 10 years of Bush & Obama–a growing number of Americans have given up on capitalism altogether. It's true! Take a look at this from GlobeScan:

"American public support for the free market economy has dropped sharply in the past year, and is now lower than in China, according to a GlobeScan poll released today.

The findings, drawn from 12,884 interviews across 25 countries, show that there has been a sharp fall in the number of Americans who think that the free market economy is the best economic system for the future.

When GlobeScan began tracking views in 2002, four in five Americans (80%) saw the free market as the best economic system for the future—the highest level of support among tracking countries. Support started to fall away in the following years and recovered slightly after the financial crisis in 2007/8, but has plummeted since 2009, falling 15 points in a year so that fewer than three in five (59%) now see free market capitalism as the best system for the future….

The results mean that a number of the world's major emerging economies have now matched or overtaken the USA in their enthusiasm for the free market. The Chinese and Brazilians, 67 per cent of whom regard the free market system as the best on offer, are now more positive about capitalism than Americans…. ("Sharp Drop in American Enthusiasm for Free Market, Poll Shows", GlobeScan)

Whoa! How do you like them apples? The Chinese like capitalism more than Americans now. Can you believe it? And look at the beating that free markets took under Obama; down a hefty 15 points in one year, even worse than Bush?!? And, do you know why? Because even though things were scarier under Bush, most people still believed we could turn things around at the ballot box. Now they know they can't. Now they know the system is broken on a fundamental level and the changes they want can't be achieved through the political process.

And Gallup wonders why we're so depressed?

As for the economy, the problem is still deflation. The Fed's zero rates and $2 trillion in monetary stimulus have revved up stock prices and sent commodities skyrocketing, but housing prices continue to fall, unemployment is way too high (8.8%), and there's excess capacity throughout the system. Personal consumption will continue to flag due to stagnant wages and battered household balance sheets. That means demand will be weak and revenues will continue to shrink. Austerity-minded congressmen will further dampen the recovery by cutting costs and reducing aid to the states.

So, who's going to invest in this environment? Who's going to bet on a rosy future of booming sales and bulging profits when they know that the government is going on a fat-free diet, liquidity is drying up, and the Fed is pulling the plug on its emergency bond buying program?

No one, that's who.

That's why the end of June could be the tipping point, because when QE2 ends, deflationary pressures will reemerge and the economy will begin to teeter.

Eventually policymakers will see that fiscal stimulus is the only way to pull the economy out of the mud, but only after they have exhausted all the other options.