

## Update on the U.S. Economy Issue #3, June 2011, by Dan North

Imagine a baseball game where Team A has scored three straight runs, but then Team B scores one. Who's winning the game? Apparently, Team B is, according to many economists. The three month period of February, March, and April scored the best job growth in six years, but when May put up a weak performance, many economists focused more on the one weak month than on the three strong ones.

Economic data has indeed been soft recently. Q1 GDP was revised down to an anemic 1.8%, home prices extended a double-dip, consumer confidence fell, auto sales plummeted 10%, the ISM index dropped, and factory orders disappointed. The all-important employment report for May was terrible, showing only 54,000 jobs gained vs. expectations of around 150,000. The previous three month streak of job gains which had been the best in six years was revised down and the unemployment rate rose to 9.1% from 8.8% in March. Explanations for the weakness included floods and tornados, Japanese supply line disruptions, uncertainty over the budget and debt ceiling negotiations and near record high gasoline prices.

With the weakness, investors abandoned stocks and headed for the shelter of U.S. Treasuries, driving the yield on the 10 year note below 3%, a development that would have been unthinkable a few weeks ago. Ironically, Treasury prices rose even as Moody's said it might put U.S. Treasury debt under review, and the largest single buyer of Treasuries, the Fed, began exiting the market this month. Apparently the market may have already priced

in these factors, while uncertainty in Europe may have also contributed to the falling yields.

These developments make any change in the Fed's ultra-loose monetary policy quite unlikely anytime soon, especially the creation of a QE3 program. Expectations of any kind of tightening have been pushed out to the end of this year at the earliest. On the fiscal side, the spending cuts / debt ceiling negotiations will likely drag on until the last minute, August 2nd, and there is still no long-term budget in place which will reduce deficits and debts and reform Medicare.

But note that even with such serious headwinds, and without the benefit of a recovering housing market, the economy is still growing, an encouraging sign of an economy which will not be easily derailed despite current weakness. And there are other positive signs as well: retail sales are holding up, corporate profits are strong, bankruptcies are falling 15% year/year, the yield curve is still strongly positive, and gasoline prices have fallen 7% from a high in mid-May. Perhaps most importantly, banks are now actually making more commercial and industrial loans for the first time since 2008, ending a credit drought which has been one of the reasons this recovery has been dragging on for so long.

It is very easy to get wrapped up in any one month's weak data, but let's keep some perspective and note that the score is still 3-1.



### About Dan North

Economist Dan North has been with America's largest trade credit insurer Euler Hermes ACI since 1996. He uses macroeconomic and quantitative analyses to help manage Euler Hermes ACI's risk portfolio of \$200 billion in annual U.S. and Canadian trade transactions. Dan ranked fourth on Bloomberg's list of the top 65 economic forecasters for 2008-2009. He holds an MBA from the Wharton School of Business.

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