



## Cautious Optimism

It's not easy to get our heads around how big the universe really is, but we can get an interesting perspective on this video, which shows how big the Earth is in comparison with other objects in the sky:

<http://www.youtube.com/watch?v=HEeh1BH34Q&feature=related>

Back on earth, some of us are asking a more practical question: how big is the economy likely to be this year?

In a recent keynote presentation in Las Vegas, David Kelly of JP Morgan Chase told an audience of financial advisors what most of us already know: that the current economic recovery has been slow by historical standards. Usually, economic growth roars back after a deep recession, but the latest numbers show a 3.2% (annualized) expansion of the US economy in the fourth quarter.

Going forward, the question in Kelly's mind is whether 2011 will see us reach 4% growth -- the level where we begin to create enough jobs to start reducing the unemployment rate.

There are several possible reasons to think we can. One is pent-up demand around the economy. Kelly noted that many large corporations have been putting off buying new technology, and told a funny story about how he asked his own IT department for a laptop to replace his broken one. They went back into the store room and came back with what Kelly described as a "legacy machine," dusted it off, applied a fresh layer of duct tape and handed it over. As part of the recent tax package, companies will be able to write off the full cost of equipment purchases this year, which means technology and equipment orders should look better in 2011 than they have the past three years.

In a bit of optimistic news, auto sales managed to increase all the way to 12.5 million units last year. But Kelly pointed out that some 13 million to 14 million cars are hauled away to junkyards each year. If you add in 2.4 million new drivers between January and December, there is reason to think that new car demand will reach 16 million in 2011.

Housing demand may be on the verge of an increase as well. Kelly showed a slide that traced a long, slow three-year recovery up to 555,000 housing starts last December. But Kelly said that this is far from normal levels. "We have 50 years of good monthly data on housing starts," he told the audience, "and prior to the recession, the lowest

number ever, since the Eisenhower Administration, was 798,000.” From this level, Kelly told the audience, the odds are more likely that we’ll go up rather than down.

Consumer balance sheets are another potential source of optimism. Seventy percent of all debt held by Americans is mortgage debt, which is being refinanced at what Kelly described as “the lowest rates we are ever going to see.” Even the darker statistics have optimistic overtones; banks are writing off mortgage debt at record rates. Add it up, and the percentage of peoples’ income used to make debt payments has been falling steadily, from a peak of 40% of disposable income in 2007 to 11.6% today.

Kelly briefly touched on record corporate profits; by the third quarter of 2010, earnings reached \$21.58 a share on the S&P 500, and could breach the all-time high of \$24.06 later this year. How is that possible in this tepid growth environment? “This kind of economy is great for profits because it holds down interest rates and keeps labor expenses in check,” Kelly told the group. “Nobody is pounding on the boss’s door to demand a raise because they think they’re irreplaceable.”

Add in the two-year extension on lower tax rates, and the payroll tax cuts, and Kelly says it isn’t a stretch to expect 4% growth for 2011.

That would reduce unemployment, right? Yes and no. The higher economic growth rate should lead to rises in job creation. But Kelly said that the 9.4% unemployment rate we see today doesn’t count people who have stopped looking for work. “If the economy starts to grow,” he said, “people are suddenly going to look up and realize that there are jobs out there again, and start looking for work.” The effect, paradoxically, will be a spike in the unemployment statistics--which most people will read as a discouraging signal, when in fact it is a sign that the economy has come back to life.

If you have children, friends or neighbors who are looking for work, Kelly had some good news for them. When you see that employment grew by 800,000, as it did last year, most people don’t realize that’s a net number. Kelly invited the audience to go to the web site [www.bls.gov](http://www.bls.gov), and look at the “Job Openings and Labor Turnover Report.” You’ll find that last year 50.8 million people were hired, while 50 million people left the work force.

“People don’t realize how dynamic our labor market really is,” said Kelly. “That means that there are 50 million resumes on various desks around the economy, and the top resumes on those piles are going to get hired this week. There are jobs out there, and a lot of people are hired in America every day.”

-- Bob Veres. Posted 02/16/11.