

Good Economic News is Steadily Piling Up

The chorus of voices announcing “recession now or if not now, soon” that was so prevalent in August and September has crept back into the hidden recesses of the Doom and Gloom Warehouse from which it never should have escaped in the first place. These voices would be quite appropriate in most of the countries of the Euro Zone (especially Greece, Italy and Portugal), Japan or many countries in Africa or South America, but their constant negativism about the US economy is sorely misplaced.

New examples of the resilience and underlying strength of the US economy appear every week. Two such bits of good news were released on December 1.

The most important of these was the report on the state of manufacturing from the Institute for Supply Management (ISM) in Tempe, AZ. They said that the [PMI](#) (formally the Purchasing Managers’ Index) was 52.7 percent in November, up from 50.8 percent in October and the highest since the 55.3 percent level in June.

The average over the last twelve months (55.6 percent) is consistent with real GDP growth over the next year of 4.5 percent according to the ISM. The November level of 52.7 percent, if continued for a year, would be consistent with real GDP growth of 3.6 percent over the period.

We will not see such strong growth in the overall economy until the small business sector picks up significantly, but that is quite likely to happen in 2012 and beyond. The [November](#) report from the National Federation of Independent Business (NFIB) said their Small Business Optimism Index was 90.2 in October (1986=100), up 1.3 percentage points from September. That was the highest level since July, but still below the average of 91.1 for the first ten months of 2011.

The PMI registered the 28th consecutive month of growth in the manufacturing sector (an index level of 50.0 percent or above). It was the 30th month of growth in the overall economy, which means the PMI was greater than 42.5 percent.

The manufacturing PMI is a diffusion index. It is calculated by adding the percentage of positive responses plus one half of those responding the same as the previous month, which is considered positive.

It is one of our oldest economic indicators, having been published every month since 1931 except for four years during World War II. It is

always released on the first business day of the month, so it's our first report on the state of business in the previous month.

The second economic release full of good news that came out on December 1 was the October [construction data](#) from the Census Bureau. That showed that total construction spending during October was running at a seasonally adjusted annual rate of \$798.5 billion. That was up 0.8 percent from September (which was revised upward to a seasonally adjusted annual rate of \$792.1 billion). It was only 0.4 percent below October 2010.

These data mean that construction will make a positive contribution to economic growth this quarter. We'll get the first estimate of that on January 27, 2012.

On November 30, the Federal Reserve, the European Central Bank (ECB), the Bank of Canada, the Bank of England, the Bank of Japan and the Swiss National Bank announced a coordinated effort to reduce borrowing costs for both businesses and consumers in all the countries involved. The agreement is that the Fed will cut the rate at which it lends US dollars to these other central banks by fifty basis points or 0.50 percentage points. There are no limits on how much the Fed will lend as it can create US dollars at will.

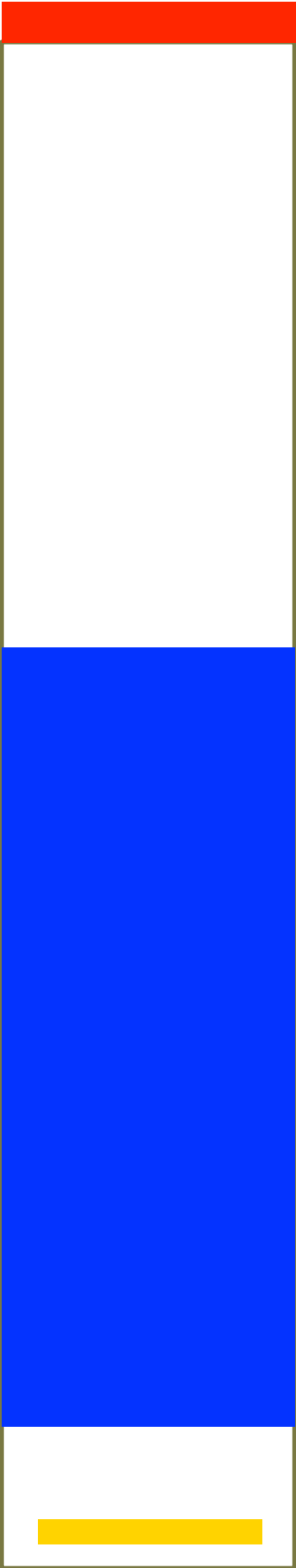
This action will help relieve the stress in European financial markets stemming from the fact that many banks are unwilling to follow their "normal" lending policies toward other banks. This has caused the three-month LIBOR (London Interbank Offered Rate) rate to rise about 25 basis points since August.

Almost every business firm in the US that borrows from banks pays a spread above the three-month LIBOR rate. Thus, borrowing costs have been rising at a time when the policy is to reduce them. Therefore, this coordinated effort by the world's major central banks should help lower borrowing costs in most of the major economies in the world. The Bank of China reduced the reserve requirements for its banks on November 30 as well.

These actions and other good economic news caused the stock market to rise sharply on that day. The Dow Jones Industrial Average rose by 490.05 points or 4.2 percent, its seventh largest point gain ever. The broad S&P 500 index increased 4.3 percent.

On November 22, the "[Second Estimate](#)" for real GDP in the third quarter from BEA confirmed that we were indeed at new record levels of economic activity then. Real GDP ran at a seasonally adjusted annual rate of \$13,337.8 billion. That was 2.0 percent above the second quarter at a seasonally adjusted annual rate and 1.5 percent above the third quarter of 2010.

The BEA report also contained the first estimates for corporate profits in the third quarter. They were at new record levels for all measures.



Total corporate profits with inventory valuation and capital consumption adjustments were running at a seasonally adjusted annual rate of \$1,977.4 billion in the third quarter. That was up 2.1 percent at a seasonally adjusted annual rate from the second quarter and a full 7.9 percent above the third quarter of 2010.

Corporate profits after tax on the same basis at a seasonally adjusted annual rate were \$1,562.6 billion in the third quarter. That was up 3.0 percent at a seasonally adjusted annual rate from the second quarter and 11.4 percent above the same quarter a year earlier.

Net dividends ran at a seasonally adjusted annual rate of \$820.7 billion in the third quarter. That was 7.9 percent above the third quarter of 2010.

On November 21 the National Association for Business Economics (NABE) released its latest [economic forecasts](#) for the US economy. The median forecast for the 42 of us in the survey is for 1.8 percent real GDP growth in 2011 on a year-over-year basis. That is expected to rise to 2.4 percent growth in 2012.

If Congress can make progress on slicing the rate of growth of government spending and thus reducing the deficit, it will be easy to see real GDP growth much higher in 2012. That would be a most welcome development, for sure.

