

ECONOMIC NEWS UPDATE

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You Said You Want Certainty

If you are one of the many who believes that uncertainty is stalling our recovery, you should be smiling. Much uncertainty has been replaced by a surer knowledge of what policy makers have in mind for the economy, and of the direction of some of the key economic indicators. If you are sure you love certainty, you might want to think again.

Start with the state of political play. President Obama used his rousing State of the Union speech to make four things clear. First, he knows that Obamacare is an albatross he will have to wear in his re-election swings through the

country: it is so wildly unpopular that he didn't dare mention it in a speech that lasted over an hour, much less offer it as his signal accomplishment, which, for better or worse, it surely is. Second, he plans to propose a series of small spending initiatives on student loans, and mortgage relief, and larger ones on infrastructure. This is the "small ball" approach that Bill Clinton so successfully used in his re-election bid. Third, he will continue to call for higher taxes on the rich, with anyone earning more than \$1 million per year paying at a 30% rate, and for higher taxes on the merely comfortable: families earning more than

\$250,000 per year. Class war to some, fairness to others.

Fourth, and most important, he knows most of these measures have as good a chance of gaining congressional approval as the rich men he rather dislikes have of squeezing through the eye of a needle in order to enter heaven, to borrow from and do a bit of violence to *Matthew*. This was not a policy speech; it was a political speech laying out the themes of his \$1 billion re-election campaign, a campaign with historic roots in Harry Truman's attack on a "do-nothing" congress -- except in this case the doing of nothing is in good part by a Democratic-controlled senate.

A possible exception to the likely failure of most of these measures to pass is the new provisions of the tax code the Treasury is now drafting. Foreign earnings of American companies are to be taxed, and they are to be given an incentive to "bring jobs home". That will prove difficult for Republicans to oppose.

In sum, uncertainty about political developments this year is now removed. We are certain to see the political process paralyzed for the rest of the year, and perhaps beyond, as intransigent Republicans face

off against an equally intransigent President, a clash if not of the titans, then of the ideologues. The deficit and debt will remain unattended, and the tax structure largely unchanged as the Republicans argue for broadening the tax base by eliminating loopholes that favor high earners, and for lowering tax rates, and the President holds to his position that fairness requires that "millionaires and billionaires", most notable among them his possible rival, Mitt Romney, pay their fair share, i.e., more. Every sensible person in town, and there are some, knows that the deficit can be attacked only by raising some taxes, directly or by closing loopholes, and reducing entitlements. But sense is in short supply in Washington.

Another uncertainty has been eliminated by the Federal Reserve Board's monetary policy gurus. Unhappy with the moderate pace of the recovery, and seeing "significant downside risks to the recovery", the Fed has promised to hold interest rates at current near-zero levels, at least until well into 2014. Too bad for savers, whom the Fed hopes will find it more fun to spend than to save without prospect of earning any interest. Good news for

borrowers, whom the Fed hopes will borrow to invest in factories and to buy homes -- if they can qualify for credit from banks increasingly nervous about lending to the likes of many of the potential borrowers who enter their august halls. The Fed also will take whatever steps it deems necessary to pep up the economy if the recovery does not soon grow steadily at an annual rate in excess of the 2.8% rate of the last quarter of 2011, a bit of good news after a paltry 1.8% increase in the third quarter. But the Economist Intelligence Unit's latest guess is that US GDP will grow by 1.8% this year, and rise gradually to only 2.3% by 2016. Economists at the Lindsey Group consultancy joke that along around 2014 the Fed will issue a statement that "rates [are] to remain exceptionally low for the rest of the decade." But remember: The interest-rate pledge extends beyond Chairman Ben Bernanke's term, which expires in January 31, 2014. A bit of lingering uncertainty as to the durability of this new certainty.

Besides, it is not clear that the Fed's pessimism is warranted, as there are signs that the recovery is accelerating. Factory production is now 15% above

its recession lows. Orders for durable goods rose 3% in January, after a 4.7% increase in November. Several of the Federal Reserve districts -- Richmond, New York and Philadelphia -- are reporting healthy gains in their manufacturing sectors. And many regional banks are reporting an increase in the demand for loans from businesses finally willing to expand.

This bounce-back is receiving significant help from a rise in exports that has accounted for about half of US economic growth since the end of the recession. Exports are growing at an annual rate of 16%, putting them on pace to reach the President's target of doubling to \$3.1 trillion by 2015 -- if the present growth rate in exports can be maintained, which some analysts doubt.

The housing market is also showing signs that it might finally have hit bottom. Sales of existing homes rose in December for the third straight month, as low interest rates and lower home prices are making homes more affordable than renting. The supply of homes listed for sale is now at its lowest level since 2006. And even in Phoenix, one of the most depressed housing

markets in the country, frowns have turned to smiles as homebuilders are stirring after a long period of inactivity. All in all, good news for Americans, which is why consumer confidence increased this month, and bad news for Republicans who have been secretly hoping that the President will not be able to claim that his policies are finally working.

This will undoubtedly be grist for the mill of at least some of the Republicans vying for their party's presidential nomination. They fear that if the recovery does accelerate, low interest rates and renewed bond buying by the Fed will allow the inflation genie to escape from its bottle. Newt Gingrich has promised to fire Federal Reserve Board chairman Ben Bernanke, which of course he would be powerless to do even if he wins the nomination and bests Barack Obama at the polls, there being the small matter of the law governing the term of the Fed chairman. Ron Paul has gone further: he would abolish the Fed if given the chance, which he won't be. Mitt Romney undoubtedly has a position on all of this, but it is not obvious to even the intensely interested observer.

So goodbye uncertainty, or at least some of it. The nation's debt will rise; interest rates will not; manufacturing will trend up, as will home sales. Feel better?