

Unexpected

July 1, 2010—Perhaps the most important economic story of 2010's second quarter concerned the Euro and what steps should be taken to restore the standing of Greece in the financial markets. Because other members of the Eurozone are on similarly shaky ground, the ending of this story remains unwritten.

The prospects for the American economy are of more immediate concern to many investors. In particular, there is one word that keeps popping up in the economic reports, a word that has become jarring with its repetition: Unexpected.

No one can accurately foretell the future, of course, but it would be nice if some of the “unexpected” developments were on the upside.

GDP

The gross domestic product estimate for the first quarter of the year was reduced a second time in June, to 2.7%. The sharp contraction from the 5.6% rate of the last quarter of 2009 was attributed to lowered consumer spending. At this stage of the recovery, many economists were expecting better. For example, following the recession early in the Reagan administration, the economy grew at rates of 7% to 9% for five straight quarters. A return to that kind of growth will be needed to make an appreciable dent in the high unemployment rate.

Retail sales fell by 1.2% in May, when most forecasters had been expecting a slight increase. It was the first contraction in retail sales since September 2009. The news called into question the strength of consumer spending in the second quarter.

Housing

The tax credit for homebuyers expired on April 30. As expected, buyers rushed to complete their purchases in time to secure the tax benefit. The purpose of the credit, to restore stability to the housing market, was not achieved. In May:

- New home sales fell 33%, to a record low. In fact, new home sales were 18.3% below the level of May 2009.

- Housing starts dropped 10%.

- New building permits fell 5.9%, following a 10.9% drop in April.

Housing weakness has led some analysts to speculate that there will be a double dip in housing, which could lead to a double-dip recession.

The homebuyer's tax credit cost the federal government more than \$1 billion, according to the IRS. A study by the inspector general for tax administration revealed that at least \$26.7 million in credits was granted in error. For example, 1,295 prison inmates secured \$9.1 million in credits—241 of them were serving life sentences. Another 2,555 taxpayers claimed and received credits for home purchases that occurred before the credit was enacted.

Business sentiment

The Business Roundtable generally has been supportive of the Obama administration's agenda. For example, it was the only major business organization that supported the overhaul of the health care system. That support wavered in June.

In a June address to the Economic Club of Washington, the chairman of the Business Roundtable, Ivan Seidenberg, warned that recent tax and regulatory policy changes are interfering with the return to a strong and growing economy. The speech came on the heels of delivery to the White House of a 54-page report itemizing the concerns of CEOs of America's largest companies.

Said the report, "Economic recovery must be led by the private sector, both large and small, if we are going to create jobs and reduce the unemployment rate."

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