

## **If Things Are Better, Why Do I Feel Worse?**

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The second quarter growth numbers showed a substantial improvement over the previous two quarters. The economy shrunk at the end of 2007 and growth was in effect nonexistent during the first three months of 2008. This jump in the growth rate will be seized upon by those like former Senator Phil Gramm (an economist by training, I'm embarrassed to say) who believe that the economy is fine and that the people are whiners. The spurt in growth came mainly from two factors: most Americans received their tax rebate checks in the second quarter and a falling dollar boosted exports. Despite the rise in growth, most surveys indicate that more and more Americans feel pessimistic about their current and future economic prospects. Why?

Most Americans see the stimulus provided by the tax checks as a transitory phenomenon. This is it until and unless the next president renews the program in 2009. While this may happen, it is likely that other concerns will have priority. Even so, the largest portion of the 2008 rebates was devoted to repaying debt, an activity that does not produce satisfaction, much less euphoria. The growth spurt attributable to these tax rebates will not continue, and taxpayers know it.

But what about exports? Here is a solid sector of the economy, one that represents what's left of American manufacturing. Won't that continue to stimulate growth? Whether it does or not (more on this later), most Americans do not work in the export sector, so the gains to income from export growth are quite limited. In short, export growth is a weak engine to pull the massive train that is this economy. Americans know this and since their own economic well being is not affected by exports, they reap no dividends from this growth.

In fact, it is unlikely that the contribution to growth that has been made by exports is unlikely to continue. First, a great deal of export growth is a function of the weakness in the dollar. American goods are simply cheaper for foreigners than they were before. A particular example of the effect of a cheaper dollar is the growing number of real estate purchases in the United States by foreigners, although these transactions are not counted as export earnings.

It is likely that the value of the dollar relative to the euro and the yen will rise in the future. It has been rising of late and given the threat posed by inflation in the United States, the Fed will, in all probability raise short term interest rates later this year and into 2009. This will bump up the value of the dollar. As American goods become more expensive in terms of other currencies, export growth will stall and exports may even shrink.

The second reason why the export growth is likely to diminish is declining growth in Europe and Japan. For a variety of reasons, the economies of the euro zone nations appear to be slowing down. In Spain and the United Kingdom, declining real estate values appear to be recreating American problems over there. In Japan, nearly two decades of stagnation continue. Significantly, the European Central Bank has chosen to increase interest rates, a policy that will increase the chances of a slowdown in Europe even as it makes American goods attractive.

So, both engines responsible for second quarter growth are short on fuel and will likely come to a dead stop. Is there anything else to take over? In a word, no. The real estate sector has bottomed out but the hangover of foreclosed properties and unsold new homes will prevent the reemergence of that driver before 2010. No other sector appears poised to move to the head of the train in the near future. That suggests that after this second quarter burst, it is likely that this economy will fall back into a pattern of slow and mediocre growth, with sluggish employment and stagnant incomes. The American people know this and they are worried. In that sense, they are better economists than the professionals.