

Rebound or double dip? Forecast for U.S. economy to 2011 | Mays Business Online

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What can we expect the economy to do in the latter half of 2010? Mark G. Dotzour, chief economist and director of research at the Texas A&M Real Estate Center at Mays Business School has a few ideas. The road ahead is filled with potholes, but Dotzour says there is hope for the future.

As we begin the second half of 2010, clearly the entire country is ready for the end of the current economic decline and the beginning of a new phase of economic expansion. There are signals that the economy is trying to turn the corner. Consumer confidence has increased from a year ago and consumer spending has resumed its relentless upward trajectory. But the most important positive indicator is that corporate profits have rebounded! In a free-market, capitalistic system like America, profits are the key indicator. When profits are growing, companies hire employees. When profits flatten, they stop hiring. When profits fall, they start to fire people, and they keep on firing people until profits start to increase again. Clearly, most businesses have right-sized their firms sufficiently to regain profitability.



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So then, why aren't they hiring people? The answer is uncertainty: uncertainty of capital gains and income tax rates; Uncertainty about the cost of health care and the possible increase in energy costs due to "cap and trade." The prospect of new and increased government regulation makes it hard for business to see clearly into the future.

Businesses can buy insurance against risk, but there is only one way to "insure" against uncertainty and that is to hoard cash. **There is now well over a trillion dollars sitting in cash on business balance sheets.** They have much more capital than the Federal Reserve, the FDIC, Fannie Mae, and Freddie Mac combined.

So, what will it take to get businesses to deploy their capital and start hiring? A new cycle of economic expansion in the U.S. will not happen until this occurs.

The answer lies in business owners seeing the opportunity to make significant profits again. It is unlikely that the issues of taxes, "cap and trade," insurance costs and new regulations will be resolved in 2010. **Hence, expect a sluggish economy through the remainder of the year.** After the elections in November and new Congress members are seated early in 2011, business owners may get a clearer picture of what the future looks like. As the uncertainty recedes, the confidence to invest, expand and hire will increase.

Many business decisions have been deferred in the past three years. There could be a pleasant economic surprise when businesses see the "all clear" signal, because of the pent up demand that has been created by several years of postponed purchasing.

A second headwind for economic recovery comes from the government sector at the state, county and city level, including school districts. All over the country, income tax revenues are down. So are sales tax revenues. Property tax revenues from commercial real estate have fallen some, and are likely to fall further in 2011. In many states residential property taxes have fallen as home prices declined. These declines in revenues are forcing government entities to make difficult decisions regarding spending and hiring. There is little doubt that there will be reductions in employment at all levels of government. The private business sector has right-sized their firms to adjust to the current environment. Individual households have increased their savings rate to pay down debt and improve their balance sheets.

Government has begun the same process, but has a long way to go yet.

Small business is crucial at this stage of the game. As the government lays people off, it will be essential that small businesses resume hiring. Otherwise, we will start losing more jobs rather than beginning a new expansionary cycle.

Look for signals from Washington. Business owners are like racecar drivers. They have a precision-tuned machine with lots of spare tires and parts. They have skilled mechanics and drivers. They are just waiting to hear from Washington that the yellow flag of government intervention has been lifted and it's time to roll back onto the track and resume the race.