Northern Trust

DAILY ECONOMIC COMMENTARY

Cash Rich Firms Will Not Hire and Invest Until Demand Gains Momentum

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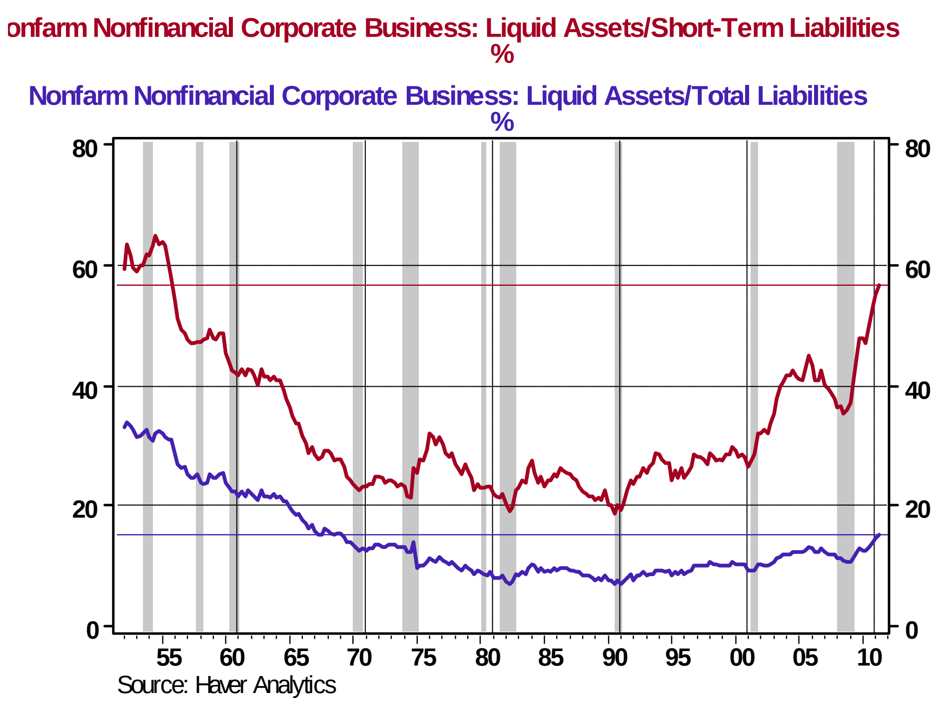
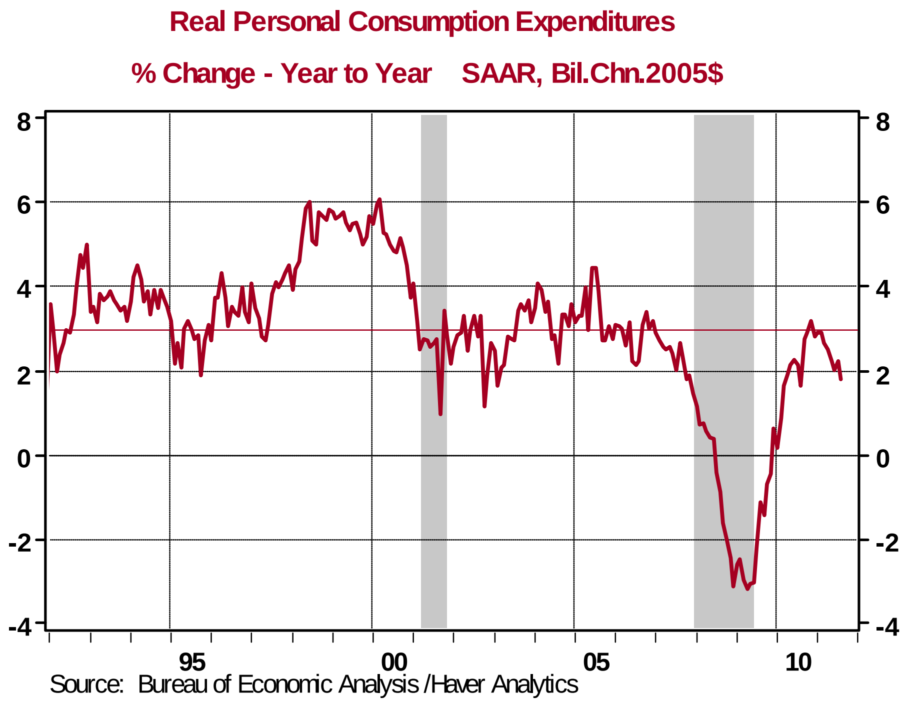
Non-financial corporate firms were holding $2.047 trillion in liquid assets in the second quarter of 2011. These liquid assets (Sum of foreign deposits, checkable deposits/currency, time & savings deposits, money market fund shares, security RPs, commercial paper, US government securities, municipal securities, and mutual fund shares) as a percent of short-term liabilities are close to historical highs (see Chart 1). It is also noteworthy that liquid assets vis-à-vis total liabilities are at the highest level since the late-60s (see Chart 1). So, what is preventing firms from increasing their payrolls, purchasing new equipment, and building new plants?

Chart 1



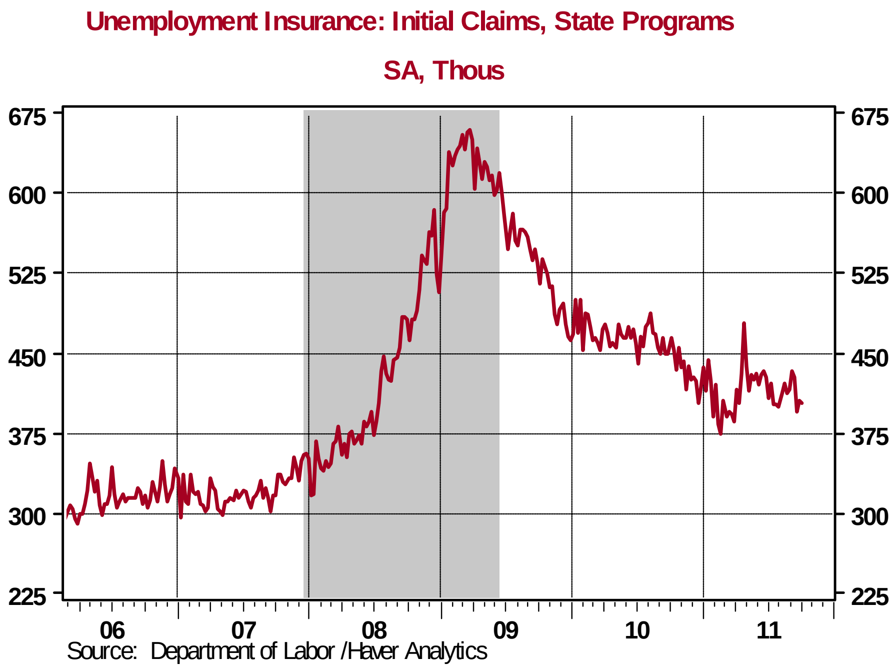
As we have written in several commentaries, a soft labor market and the resulting soft trend in consumer spending are factors that explain tepid business conditions. On average, consumer spending in the last 20 years grew at a nearly 3.0% pace (see Chart 2); the pace of consumer spending in the June-August months has slowed to 2.0%, an entire percentage point decline in the largest component of GDP.

Chart 2



The elevated unemployment rate (9.1%) after four years of economic recovery remains at top of the Fed's worry list. The latest initial jobless claims report once again indicates reluctance on the part of firms to hire. Initial jobless claims fell 1,000 to 404,000 during the week ended October 9. Continuing claims, which lag initial jobless claims by one week, declined 55,000 to 3.67 million.

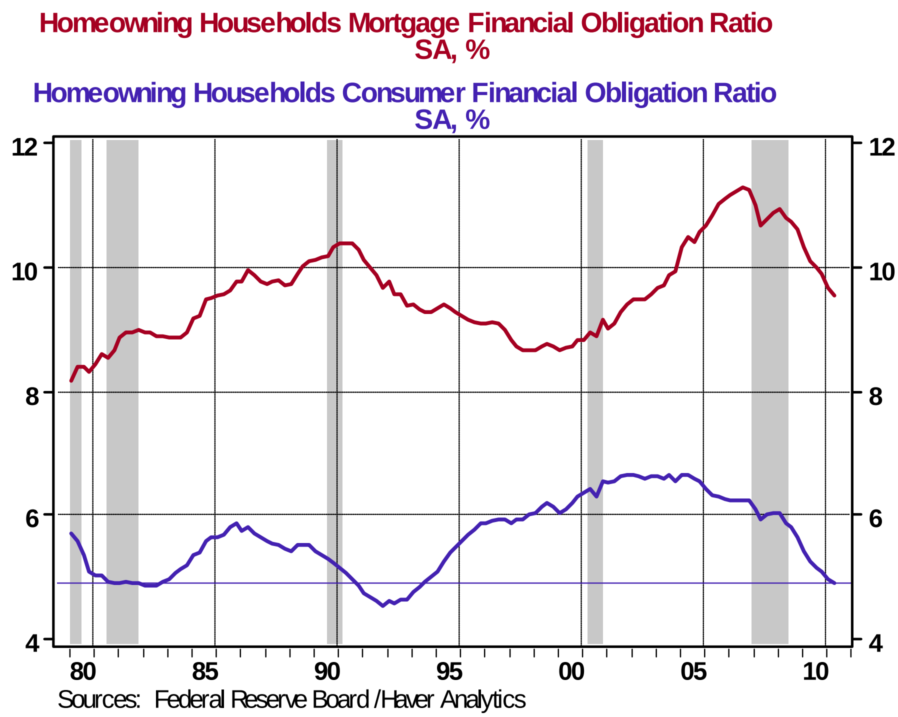
Chart 3



Households have shifted from a spending frenzy prior to the onset of the crisis to a phase marked with balance sheet consolidation, particularly by paying off debt. The non-mortgage financial obligation ratio (minimum debt service obligations as a percent of disposable income) has declined to 4.9% in the second quarter of 2011 (see Chart 4), the level last seen in 1994.

The current focus of deleveraging in an environment of soft labor market conditions has translated into a deceleration of consumer spending. In other words, strong and sustained consumer demand is the key to shake off this economic stupor and get cash rich firms to hire and invest.

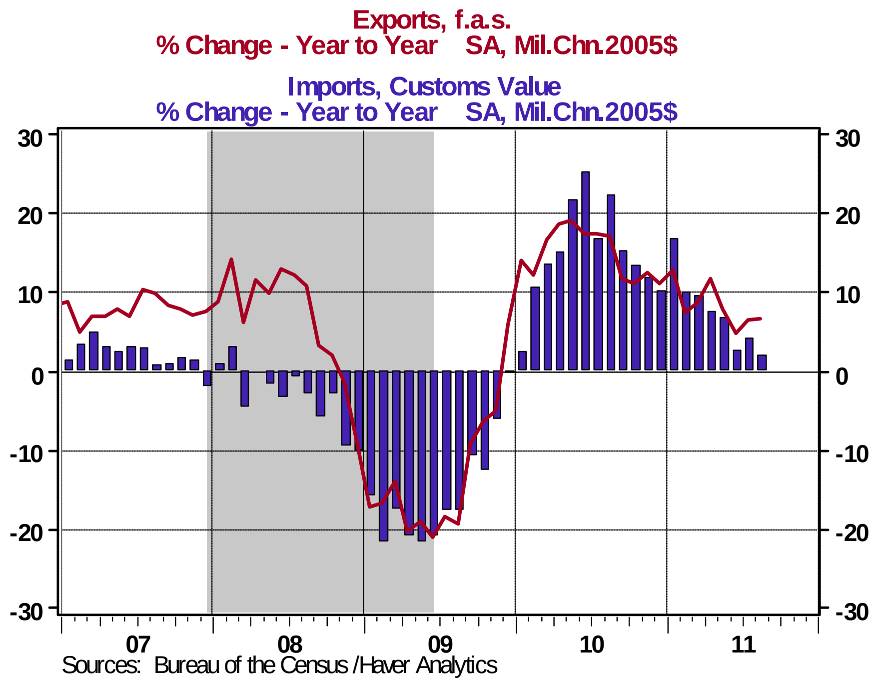
Chart 4



United States and China: International Trade Data Underscore Softening Economic Fundamentals

The trade gap of the U.S. economy was virtually unchanged at $45.6 billion in August. Exports of goods and services held steady in August, while imports of goods and services also were almost unchanged. The real trade deficit of goods widened to $47 billion from $46 billion in July, reflecting a drop in exports of goods (-0.7%) and a 0.2% increase in imports of goods. From a year ago, exports of goods rose 6.7% and imports of goods moved up 1.9% (see Chart 5). The main message from Chart 5 is that tepid growth in the United States has held back imports compared with the situation in August 2010 and slowing conditions in Europe combined with non-Japan Asia trying to rein in inflation has resulted in only a moderate increase in exports from a year ago (see Chart 5).

Chart 5



The export and import numbers of China are equally telling about underlying fundamentals in China and its major trading partners. Exports and imports of China grew at a double-digit pace in September (see Chart 6). But, there is a visible deceleration in place now; exports of goods increased 17.1% in September 2011 vs.+25% in September 2010, reflecting weakening demand from abroad and a stronger currency. Exports of China to the US, EU, and Asia &the Middle East, the three major export destinations of China, show a slowing trend (see Chart 7), with the US and EU showing a larger deceleration compared with Asia and the Middle East. Goods imports of China grew 20.9% from a year ago compared with a nearly 39% jump in 2010 (see Chart 6), implying that economic momentum of China is also slowing.

Chart 6

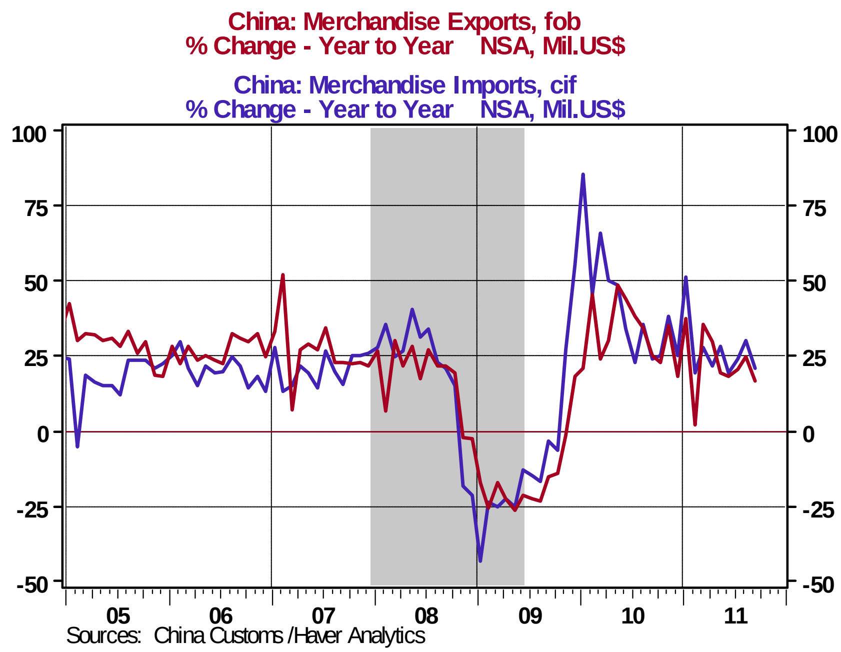


Chart 7