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U. S. Economy Reaches Milestone
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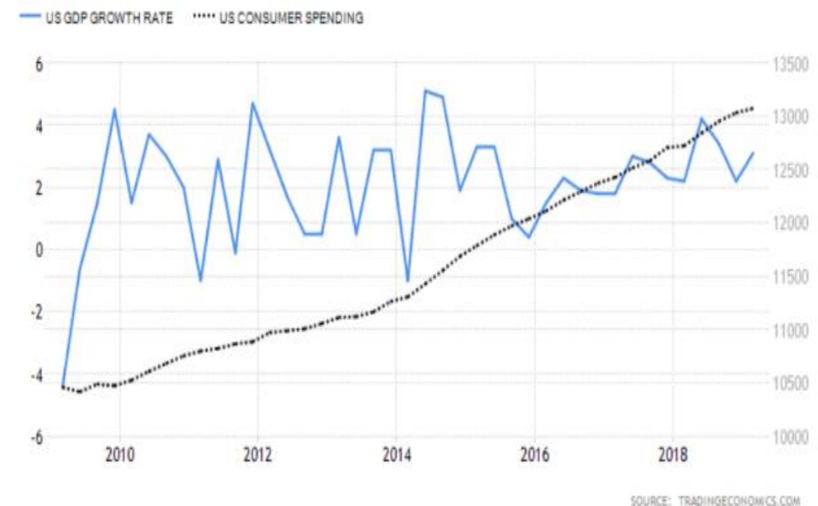
The U.S. economy reached a 10-year milestone in June, representing the longest economic rise and surpassing the expansion of the 1990s. Since World War II, the average expansion has lasted 58 months (WSJ 6/4/19). This time around, it has been at a much lower rate of growth. In fact, while past recovery periods where driven by lower interest rates and private sector credit, this experience has been quite different. Fed policy interest rates have remained very low for a long period of time, not seen since the end of the second world war. Instead of bank credit growing to fuel the growth, it has been the Federal Reserve that deleveraged member banks by forcing them to reduce loans. The Federal Reserve bank simply borrowed reserves from member banks and used the cash to purchase bonds and mortgages in the open market – thereby providing liquidity and cash to the securities market, not the consumer. When banks provide or expand credit and liquidity to the private sector the velocity of money rises at a much higher rate than when the Federal Reserve buys bonds in the open market as it did aggressively until recently. Increasing the velocity of money is what speeds up economic growth, by increasing the number of transactions between people and businesses. By reducing bank credit, the Fed induced a drag on the recovery, but at the same time it took interest rates to near zero, as a means of stimulus. This explains why the growth rate of the 10-year recovery has been slower than in the past, perhaps anemic.

As expansions age and unemployment becomes low, economists assume that wage pressures will drive up costs leading to higher inflation. This logic assumes the Federal Reserve will intervene by raising interest rates – which ends the growth cycle. MIT economist Rudi Dornbusch once wrote in 1997 that "every U.S expansion in the past 40 years was murdered by the Federal Reserve."

In the spring of 2018, many economists wrongly predicted that a recession would begin in the second half of 2019. This view stemmed from a belief that low unemployment would soon force the Federal Reserve to raise interest rates. In fact, Fed tightening ended in 2018. The consensus opinion of four rate increases to occur in 2019 was dead wrong.



According to Larry Kudlow, export growth is now adding one percentage point to the Gross National Product (GDP) growth rate – now at +3.2%. This is what happened in year 2018 and so far in 2019. And this follows a 10-year period of GDP growth, averaging 2.0% per year. Oil and gas related export growth is one reason for the 50% growth in GDP. Other factors include increased military exports and massive government spending.

Wage growth has been slow, but when adjusted for inflation, it has been solid. Recent enhanced worker productivity is related to the use of more technology. With inflation below its 2.0% target, it is unlikely the Fed will be tapping on the brakes any time soon.

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