In the wake of an extreme economic event, such as the Panic of 2008, everyone wants to know where we are going. To get a handle on that, we must first understand where we have been.

The ability to interpret and understand economic data in terms of patterns, relationships, connections and structures that are likely to prevail in the future is critical if we are to make sound economic decisions today. Accurate topological patterns—in short, good diagrams—hold the keys to developing useful images of the future. To that end, a series of charts are presented for both the United States and Europe.

Aggregate demand in the U.S., as measured by nominal final sales to domestic purchasers (FSDP), has trended at an annual rate of 5.1% since 1987 (see the accompanying chart). There have been ups and downs, with three demand bubbles occurring during the years in which Alan Greenspan was Chairman of the Federal Reserve. The most dramatic collapse in aggregate demand occurred after the Panic of 2008. Although FSDP has rebounded sharply from its low in the second quarter of 2009, it is growing at a below trend rate, suggesting that the U.S. is in a growth recession.

This picture is confirmed by taking a look at the Federal Reserve Bank of Chicago’s National Activity Index. The index is a weighted average of eighty-five monthly indicators. A value of zero signals that the economy is growing in line with long-term trends. Positive and negative readings signal above and below trend growth.
rates, respectively. As the accompanying chart shows, the U.S. economy is struggling.

Broad money growth (or lack thereof) explains why the U.S. economy is flat in the water. The best metric for U.S. broad money is the Divisia M4 measure (see the accompany chart). Unlike conventional money supply measures that represent the simple sum of the components of the money supply (with each component carrying an equal weight), the Divisia metric assigns a weight to each component. The weights are a function of the usefulness that each component of the money supply possesses as a medium of exchange. So, currency, traveler’s checks, and demand deposits receive a relatively “high” weight; whereas, institutional money market funds receive a relatively “low” weight.

The money supply growth rate, while no longer contracting as it did after the Panic of 2008, is barely growing. It’s no surprise that the economy is treading water, at best.

And the picture going forward doesn’t look very rosy. If we look at the weekly leading index for the U.S., it’s not signaling “boom,” but weakness and another recession. And this just isn’t any leading index. It is the one produced by the Economic Cycle Research Institute, an organization founded by one of the fathers of leading indicators Dr. Geoffrey H. Moore. It is worth noting that the Institute has correctly predicted the beginning and end of the last recession, and that, over the past fifteen years, it has spotted the onset of each recession, with no false alarms.

What happens in the U.S. and elsewhere will be conditioned by what occurs in Europe. Using the simple sum M3 broad money measures for selected European countries and the euro area (Divisia measures aren’t publically available), the picture is grim. Indeed, the money supply is contracting in Spain, Portugal and Italy; it’s collapsing in Greece; and it’s barely growing for the entire euro area. This suggests that a deflationary slump is in the cards for Europe. Accordingly, we should not be surprised that the premiere business cycle research institute in
America is signaling more trouble ahead for the U.S. economy.

Where does this leave President Obama and his potential Republican challenger in the Presidential race that will be decided in November? From when I last made an estimate of the U.S. economy’s Misery Index on President Obama’s watch (September 2011), the Index has actually improved and so have President Obama’s chances of being reelected.

Just what is the Misery Index? The Misery Index (see the accompanying chart) is calculated by adding the difference between the average inflation rate over a president’s term and the average inflation rate during the last year of the previous president’s term; the difference between the average unemployment rate over a president’s term and the unemployment rate during the last month of the previous president’s term; the change in the 30-year government bond yield during a president’s term; and the difference between the long-term, trend rate of real GDP growth and the real rate of growth during a president’s term. I have forecast what President Obama’s most likely Misery Index score will be at the end of his current term. While President Obama’s score (2.15%) is miserable, it is better than what it was when I last estimated it at 3.6% in September 2011.

For President Obama, the Misery Index has moved from very, very miserable to just very miserable. Perhaps that explains why people who are participating in the predictions market Intrade (and are putting their own money at risk) have moved from giving President Obama less than a 50% chance of victory back in September 2011 to a 59.9% chance, today. In politics, as well as exchange rates, everything is relative because one is often forced to compare two unattractive alternatives.

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Sources: Bureau of Labor Statistics, CPI-U Index; Bureau of Labor Statistics, Current Population Survey; Bureau of Economic Analysis; U.S. Federal Reserve; International Monetary Fund, World Economic Outlook, September 2011; Congressional Budget Office; Federal Reserve Bank of St. Louis and Author’s Calculations.