The Philadelphia Inquirer

On paper, economy is strong, but it doesn't feel strong

By Mark Zandi, April 27th, 2014

Would it surprise you to know that the U.S. economy has been growing for nearly five years? Or that more Americans are working in private-sector jobs than ever before? How about the fact that U.S. households are as wealthy as they have ever been?

These are important milestones, but somehow they ring hollow. The economy doesn't feel nearly as good as these statistics suggest. The recovery has been plodding, not at all like the robust growth experienced in past recoveries.

The preconditions for a much stronger economy seem to be in place. Households have repaired their balance sheets, and while student loans are a problem, overall debt burdens are low by historic standards. Homeowners have taken advantage of extraordinarily low interest rates by refinancing their mortgages and locking in those rates.

The nation's banks are well-cushioned against losses, and have stepped up their lending substantially. Bank loans to small and midsize businesses are growing at a healthy double-digit annual pace. It is still difficult for first-time home buyers to qualify for loans, but this is changing quickly.

Most encouraging is that U.S. companies are in excellent financial shape. Corporate profits have skyrocketed, businesses have significantly pared back on debt, and many are awash in cash. Firms have also aggressively reduced costs and are thus highly competitive in global markets. Adding to this, the shale revolution is likely to keep energy costs low for years to come.

Yet hiring and investment remain lackluster. This is perplexing.

Businesses have yet to experience the *Field of Dreams* moment that normally occurs in every recovery, and that is central to stronger growth. Just as Kevin Costner's character in the film is told to "build it and they will come," managers realize they can no longer grow profits by cutting costs. Instead, they must take the risk of investing despite uncertainty.

But current data show a dearth of risk-taking in America. Newly formed businesses created close to 3 million jobs in 2012 (the latest period available), not much more than were created during the 2008-09 recession. By comparison, 3.6 million jobs were created in 2007, and 5 million were created in 1999, during the technology boom.

New firms able to quickly expand such as Facebook and Twitter are especially important, catalyzing lots of job creation and investment. Indeed, while many have focused on the plight of small businesses, the dearth of these so-called gazelle companies has been a bigger constraint on growth.

Theories abound for the fall-off in entrepreneurship: The pace of technological change has moderated since the Internet-fueled boom at the turn of the century. Fewer people are in their 30s, a period when people are most likely to start businesses, and student loan debt holds many thirtysomethings back. The cost of health insurance discourages potential entrepreneurs from leaving employers who provide coverage. The flow of foreign immigrants, who are by definition risk-takers, has slowed.

All of these factors likely have some impact. But also important are lingering nightmares about the Great Recession, which subsequent events made harder to shake than usual. From financial-regulatory and health-care reform to the European debt crisis to Washington's budget battles, there has been much to be nervous about. Shaky nerves stifle risk-taking.

It is hard to know for sure, but there are indications that these anxieties are fading. Mergers and acquisition activity is heating up, and businesses are paying out more in dividends or buying back stock. These don't take as much courage as does expansion or investment, but they are a good sign.

Washington politics also seem less threatening. Given the fallout from last year's government shutdown, it is clear that gridlock is not a winning political strategy, nor is threatening to default on Treasury debt.

It is even possible that political dynamics could change in Washington after the midterm elections, enabling some substantive policy-making. Immigration reform seems most possible, given that this may be a key issue in the 2016 presidential race. Less likely but also possible is corporate tax reform: Both Democrats and Republicans want to reduce tax preferences for businesses and use the increased revenue to pay for lower corporate tax rates.

Businesses seem to be getting closer to that *Field of Dreams* moment. If only one CEO in an industry decides to launch a major expansion, CEOs of competing companies will quickly follow. None will want to lose market share when it is already so tough to grow revenue.

Business leaders know what they want to do. They've long been planning, and it is just a matter of executing those plans. Once they do, economic growth and job creation will quickly kick into higher gear.

Mark Zandi is chief economist of Moody's Analytics. help@economy.com

http://www.philly.com/philly/opinion/20140427_On_paper__economy_is_strong__but_it_doesn_t_feel_strong.html