**John Dessauer Investments, Inc.**

**John Dessauer's market review and update as of Wednesday July 22, 2020**

Both Congress and the President are working on a fifth stimulus bill. The media seem to agree that more government borrowing and spending are needed to keep the economy afloat during this pandemic. But news from China suggests our approach to the pandemic might not be the best.

In the second quarter China's official data show growth of 3% in gross domestic product. In sharp contrast, the U.S. economy is expected to report a drop of close to 10% in the second quarter.

China's pandemic strategy of draconian early lockdowns followed by modest, rather than overwhelming stimulus is paying dividends. Of course, China's official figures must always be taken with a grain of salt, especially right now. China wants to show the world how much better they have handled the pandemic than other countries, especially the United States. However, there are measures that can be independently verified, such as imports and exports. Both are bouncing back strongly. In June, for the first time since February, China's exports grew year-over-year, rising 2.7%, after falling 16.7% in May. Output of computers was up 27% year-over-year. Cellphone production fell 15% in April, but recovered to 2% growth in June. To be sure there are pockets of weakness. Retail sales were down 1.8% in June from a year earlier and private sector investment remains weak.

"Headline figures aside, what is clear is that China is experiencing something closer to a V-shaped recovery than any other major economy. Growth is likely to slow in the second half but still be faster than in most other places." (The editorial board of the *Wall Street Journal*)

In the United States we are celebrating signs that the worst of the economic contraction is likely now behind us. In the second quarter U.S. industrial production dropped at a 42.6% annual rate, the worst since the American economy demobilized in the aftermath of World War II. Industrial production plunged a record 12.7% in April. Then came May and June. The Federal Reserve reported that industrial production rose 5.4% in June and 1.4% in May. The turn for the better was broad based. Factory production was up 7.2% and production at utilities was up 4.2% in June.

Retail sales increased at a seasonally adjusted 7.5% in June, the second straight monthly increase.

The continuing rise in COVID-19 cases in the United States, due to the partial reopening of the economy, makes it difficult to forecast the future. The level of uncertainty remains very high.

The longer-term outlook is also uncertain because of the overwhelming federal government stimulus passed by Congress. The numbers coming from the Congressional Budget Office (CBO) are staggering. The CBO says for the first nine months of fiscal 2020, federal spending hit a record $5,005 trillion. Most of the increase is due to the four COVID-19 stimulus bills already passed by Congress. Tax receipts were down only 13% in the first nine months and much of that reduction is due to changing the due dates for 2019 taxes. So, some of the decline in tax receipts will be made up as taxes are paid in July.

Do we really need a fifth stimulus bill? Tens of billions of stimulus dollars haven't been spent by Congress. That plus the evidence from China suggests that a fifth bill may not be needed and may even be a threat to future growth.

Joe Biden, the Democrat contender for president, says if elected he will reverse the Trump tax reforms. But he ignores the boost those tax reforms gave the economy. The best long-term solution to our rising national debt is economic growth faster than the growth in the federal deficit. Raising taxes can inhibit growth.

The United States is not alone. Britain's Office of Budget Responsibility warned that this year's fiscal deficit could be anywhere between 13% and 21% of GDP. France, Spain and Italy are similarly facing enormous government deficits.

Joseph Steinberg, writing for the *Wall Street Journal* says: "Expect politicians on the left to seize on high pandemic deficits and debt loads as an opportunity to overhaul taxation, and not for the better."

Beyond rising taxes there is another potential threat to the future: namely the consequences of the unprecedented rise government spending and borrowing. The U.S. Treasury is already testing the markets to see whether there are practical limits to how much the U.S. can borrow on the cheap. No doubt, with so many governments ramping up their borrowing, global credit markets will be strained. Interest rates may rise even with inflation low, to attract enough capital to finance all the deficits.

Fortunately, inflation remains very low. Over the past twelve months, consumer prices have increased only 0.8% while core inflation is up just 1.2%. In addition, the Federal Reserve intends on keeping interest rates low for the foreseeable future. However, the Federal Reserve cannot control the global forces of supply and demand for credit. The unprecedented size of governments' global demand for credit makes the case for rising interest rates in a low inflation environment plausible.

Economists at the Bank for International Settlements coined the term "debt trap" to describe a situation in which prolonged low interest rates induce the accumulation of so much unproductive government and private debt that to raise interest rates would risk a catastrophic financial-system or fiscal crisis. The huge pandemic stimulus spending bills threaten to put the U.S. and other governments in that debt trap.

Joseph Steinberg writing for the *Wall Street Journal* says: "The result is a brittle economy that churns out too many houses, financial assets and overindebted retailers, and too few productive job opportunities—and creates one financial crisis after another. That's a fate worse than any tax hike. The worst part is we'll probably get both the taxes and the financial crisis before this pandemic-debt story is done."

It might be better for Congress and the President to slow down and wait to see if a fifth big spending bill is necessary. But in an election year that may be asking too much.

Meanwhile we should enjoy the improving economy and pay close attention to second quarter earnings results on our stocks. So far, we are looking good.

I will have the next market review and update one week from today on Wednesday July 29, 2020.

All the best,

John Dessauer