Written by **Bob Adelmann** on June 5, 2013

Slowing Economy Confirmed

A report on the U.S. job market from Automatic Data Processing (ADP) on Wednesday morning surprised economists once again by coming in substantially below their expectations. The 135,000 new private-sector jobs created in May were way below the 170,000 estimated by economists polled by Dow Jones Newswires. Mark Zandi, chief economist for Moody's Analytics, which produces the report for ADP, tried to put a positive spin on the disappointment:

> The job market continues to expand but growth has slowed since the first of the year.
>
> The softer job market this spring is largely due to significant fiscal drag from [January's payroll and income] tax increases and [from] government spending cuts.

A closer look behind the headlines reveals that all of the new jobs were in the service sector while manufacturing actually declined. And only four out of 10 of those jobs came from small businesses with fewer than 50 employees. Medium and large employers made up the rest.

On Monday the Institute for Supply Management (ISM) noted that economic activity in the manufacturing sector contracted for the first time since last November, with key elements of its various internal indexes declining significantly. Its primary indicator, the PMI, dropped by nearly two points, to 49 (50 is neutral), while new orders fell even further, from 52.3 to 48.8. Its production index lost even more ground from April, dropping to 48.6 from 53.5. Its backlog of orders index slowed by five points, contracting from 53 to 48, indicating further slowing in the manufacturing sector in the months to come. ISM quoted typical comments from its customers, including this from a maker of fabricated metal products, "General economy seems sluggish and pensive," while a supplier of heavy machinery said the "downturn in European and Chinese markets is having a negative effect on our business."

The Baltic Dry Index provides of measure of shipping activity worldwide by comparing demand for cargo ships with the available supply and is considered to be a leading economic indicator because it predicts future economic activity. From a high of 940 in mid-March, the BDI has declined sharply since then to just over 800.

Steve Hanke, a Cato scholar, isn't surprised by any of this. It's the unintended consequences of following blindly the Keynesian "remedies" for a soft economy by reducing interest rates through expanding the money supply. This often causes entrepreneurs to make investments that they otherwise wouldn't, simply because the cost of capital is so cheap. It's the same belief that caused many homeowners to buy homes they couldn't afford just simply because terms were so liberal and interest rates were so low.

But this time it isn't working. Entrepreneurs have gotten burned before, and many have learned their lesson. And, Hanke says, banks aren't willing to lend, even if an entrepreneur decides to try to borrow. Says Hanke:

> As it turns out, the Fed's "stimulus" policies are actually exacerbating the credit crunch. Since credit is a source of working capital for businesses, a credit crunch acts like a supply constraint on the economy. This has been the case particularly for smaller firms in the U.S. economy.

Hanke explains that when a borrower seeks funds for his enterprise, his banker must assess the risk his bank is willing to assume and whether or not he can sell part of the risk through the "interbank market." But that market isn't functioning now, and so rather than risk the bank's capital, he prefers to keep it safe, usually at the Federal Reserve.

The impact of this Keynesian attempt to jump-start the economy by trying to fool investors into taking risks they otherwise wouldn't is falling directly on the primary job creators in the economy: small businesses. Hanke points out:

> These small businesses make up a big chunk of the U.S. economy — 49.2% of private sector employment and 46% of private sector GDP.
>
> The untold story is that the zero-interest-rate trap has left [small and medium-sized companies] in a financial straitjacket.

The reports from the ADP and the ISM, along with the Baltic Dry Index, merely measure the failure of the Fed's attempt to stimulate, and are one more indication of how the private market has become non-functional in the process. Let's not look for jobs to come from small businesses or for growth in the economy until the Fed stops its Keynesian "remedies."

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