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## ECONOMIC NEWS UPDATE

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### **Economists: Often Right, Not Always Clear**

“Do I contradict myself?

“Very well then I contradict myself.”

Is this description, used by poet Walt Whitman in his classic “Leaves of Grass”, fairly applied to economists trying to explain what is going on in the US and world economies? I think not, although the information pouring out of the economic punditry is quite capable of creating confusion.

Start with the recent plunge of the dollar, now well above \$2-to-the-pound and heading to \$1.40 for the euro. One set of economists warns that this will drive up the cost of imports, and reduce the competitive pressure on American producers. Result: inflation, higher interest rates, and a slowing economy.

*Really?* If you find that analysis disturbing just tune into another set of experts. They point out that the falling dollar is making American goods cheaper overseas, spurring sales of made-in-America goods, and encouraging a wave of free-spending

tourists to come to America and fill our hotels and restaurants. Result: lots of new jobs, investment by export-led industries in new plants, and rapid economic growth.

Believe both. The falling dollar is quite capable of producing all of the consequences -- the good, the bad and the ugly -- predicted for it. But that's where Ben Bernanke and the Federal Reserve Board's monetary policy committee come in. They can cool the economy by raising interest rates if the weak dollar threatens to trigger inflation or overheating. No reason to believe they aren't up to that bit of monetary policy management; they've done fine so far.

Then there are the problems in the subprime mortgage market. One set of experts warns that the higher interest rates demanded by lenders will exacerbate problems in the ailing housing market; kill many private equity deals; drag down share prices; cause billions in losses for investors who piled

into hedge funds; and scare consumers out of the malls.

*Really?* Other experts will tell you that the wake-up call for lenders is a healthy development. It will put a stop to improvident lending before the banks become so over-extended that they create a credit crunch that curtails lending to sound borrowers. We are coming to the end of an era of excess liquidity -- so much money sloshing around the world that borrowers who couldn't possibly repay were showered with loans, and companies were encouraged to borrow too much money (over-leveraging, in the jargon of the trade). Prudence has made her reappearance in the nick of time. Banks might be forced to hold onto loans they previously off-loaded to investors, but that doesn't mean that the paper they are holding is worthless.

Believe both. As the collapse of the Bear Stearns hedge funds shows, many investors will find that they underestimated the risk they took on when they plunged into the subprime lending market. Some private equity operators now have to pay more for the capital they want to borrow, as Cerebus Capital Management is finding as it tries to complete the takeover of Chrysler Group, and Kohlberg Kravis Roberts is finding as it closes in on Alliance Boots, the UK drugstore chain. But the result will be more sensible pricing of acquisitions, and more efficient allocation of capital. We might be at the end of what Henry Kravis a few months ago called "the golden age" of private equity, but there is still plenty of money around to fund sensible deals on sensible terms.

Consider, now, oil and petrol prices. One set of analysts says \$80 crude oil and \$3-per-gallon gasoline will

force consumers to divert spending from apparel, furniture and vacations to the more crucial role of keeping their SUVs rolling. Meanwhile, airlines, trucking companies, and chemical companies that rely on petroleum-based inputs will be forced to raise prices. The Fed will respond by raising interest rates to contain the resulting inflation. Result: recession.

*Really?* Other economists chortle that higher gasoline prices will force consumers to cancel some of those cross-country vacation drives, auto manufacturers to accelerate the introduction of more fuel-efficient vehicles, and increase the attractiveness of investments in alternative fuels. The results will be a reduction in America's reliance on crude oil imported from unstable regions and countries with regimes hostile to America, and a lower trade deficit.

Believe both. In the near-term, high gasoline prices will indeed force consumers to spend less on other things and put pressure on lots of firms to raise prices. Not good. But the vigor of global competition will make it difficult for manufacturers to pass on higher costs, and the nation's security interests are served by the cut-backs in oil imports resulting from higher prices: short-run pain for long-term gain.

Finally, consider the airline industry. Many airports are so overloaded with passengers, and so burdened with inefficient management, that getting from curb to plane is a nightmare. Add that airlines have reduced staffing levels, can't seem to arrange for the coincident arrival of passengers and baggage, and are recording more delays and cancellations than ever, and you have a picture of a

transport system on the verge of collapse.

*Really?* The crush of passengers can be looked at another way. For one thing, it shows that air travel has become more affordable, enabling more and more people to take short vacations or visit grandma in her sun-speckled retirement home. For another, overcrowding at major airports is encouraging better utilization of less-crowded facilities such as Stansted in Britain and T.F. Green in Providence, Rhode Island. Finally, higher load factors (industry jargon for crammed cabins) mean airlines are making money, and can afford a new generation of quieter, more fuel-efficient, more comfortable aircraft.

Believe both. This summer is a nightmare for travelers. Flights are being delayed and canceled, baggage is being lost, overworked staff is moving from merely surly to mutinous. But public anger has forced the boss of perhaps the worst-run airport, London's Heathrow, to resign, governments are re-examining the balance between security and convenience (look for the end of the one-carry-on bag rule in Britain), and there may be flat-bed seats in all of our futures.

Do we economists contradict ourselves? Not really. We are dealing with the massive and diverse US economy, to which Whitman's self-description applies: "I am large, I contain multitudes."



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