

ECONOMIC NEWS UPDATE

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A Slow Down Is Not A Recession

“Headwinds”, “volatility”, “mortgage-related assets”, “CDOs”, “FDIC”, “auction rate securities”, “false bottom”, “recession”. “Words, words, words,” as Eliza Doolittle screamed at Professor Higgins’ insistence on precision in their pronunciation and usage. We have been deluged with new and often confusing terms. And some old and confusing ones as well.

Most important is “recession”. There is a widespread misunderstanding that we are in a recession when the economy records two quarters of negative growth. So when the GDP growth figure for the last quarter of 2007 was revised from a positive 0.6

percent to a negative 0.2 percent, it seemed that one more such negative number, and American would be officially in recession. Not so. It is up to the non-profit National Bureau of Economic Research (NBER) to decide whether America has slipped into recession, and it doesn’t do so unless in its judgement there is “a significant decline in economic activity spread across the economy, lasting more than a few months.”

If the folks at the NBER spent their days listening to the cries of pain in the halls of such as Merrill Lynch, which has taken write-downs of \$46 billion in the past year, and recently sold off

some assets at 22 cents on the dollar (and lent the buyer most of the money to complete the sale), they would long ago have signalled “recession”. But if instead they listen to men on the hard edge of the consumer economy, they might think things are booming: Bob Iger, CEO of Disney, last week reported more than satisfactory earnings growth, especially in the company’s theme parks, and said he sees no sign of recession,

The NBER recession-callers might instead turn for guidance to leading central bankers. But it would avail them little. Gary Stern, president of the Federal Reserve Bank of Minneapolis, thinks the economy is in bad shape and getting worse. He told the Financial Times, “I do not think that the headwinds have diminished. If anything, I think that they are picking up a little steam.” Which is consistent with what the Fed’s survey of business conditions reports -- sluggish consumer spending, declining manufacturing activity, weak residential real estate (property) markets. Throw in reports of the unwillingness of banks to lend -- the \$150 billion drop in the past year in credit available to businesses is the largest since the 2001 recession -- and you have “headwinds” of gale force.

But simultaneously, many Fed officials are passing the word that their major concern is inflation. The economy continues to grow, at the modest but nevertheless positive rate of 1.9 percent in the second quarter (twice the rate of the first quarter, but watch for revisions); exports are up over nine percent, adding perhaps two percentage points to GDP growth; oil prices seem to be easing; 74 percent of Americans characterise the financial situations of their households as “very good” or “fairly good”; and even though the jobs market is weakening, unemployment at 5.7 percent remains relatively low by historic standards.

So the NBER team is holding fire. In an important sense, it is taking its clue from Humpty Dumpty, who told Alice after she stepped through the looking glass, “When I use a word, it means just what I choose it to mean -- neither more nor less.”

What the NBER chooses to have the word “recession” mean might be irrelevant, in the end. Many observers, among them Democratic politicians in control of congress and therefore in a position to affect the course of the economy, say if it feels like a recession, it is a recession, no matter what some irresolute academics say or don’t say. And if it is a recession, they continue, we

have to act accordingly. If confusingly.

Democrats are calling for restrictions on free trade. No more trade-opening agreements. Tighten those already in existence. No mourning at the announcement at the death, after a seven-year illness, of the Doha Round at the hands of politically powerful farmers around the world. Never mind that such steam as the US economy currently has is generated by exports -- the trade unions, which claim that America has lost two million jobs to China, are in the saddle and ride Democratic policy.

The same Democrats who want to cut the trade that is giving the economy a boost are demanding another stimulus package. But not one that puts money directly into the pockets of consumers, as the last one did. Instead, they want to hand perhaps \$50 billion to state and local governments that are experiencing declining property tax receipts. The assumption is that the recipient governments would spend the funds on infrastructure projects. Lord Keynes is smiling down upon the Democrats, or up at them, depending on your view of the current location of the great economist.

Republicans are less enthusiastic about a second

stimulus. They see such a move as pure politics. Ed Lazear, chairman of the President's Council of Economic Advisers, points out that many checks are still in the mail from the first stimulus, and that the optimists have been proven right. It is the first anniversary of the credit crunch, one that Alan Greenspan says is of a once-in-a-century magnitude, but the problems in the financial and housing sectors have not thrown the overall economy into recession. To which this cautious economists would add, "Not yet".

The plain fact is that it is extraordinarily difficult to decide just what is going on. We know a few things. Part of the economy's problem is the high level of oil and gasoline prices. Those prices will not ease until supply increases and demand falls. The latter is indeed happening, as high prices cause reductions in auto use. But Democrats in congress are unwilling to open important offshore and Arctic areas to drilling, as Speaker of the House Nancy Pelosi says it is her mission to "save the planet" by reducing use of fossil fuels. The vast majority of Americans rather wish she saw her life's work as getting America off foreign oil.

We know, too, that the financial sector remains in shaky condition. A few banks have

already failed, and others certainly will. Deposit insurance has prevented these failures from triggering runs on other banks, but the reports nevertheless unnerve consumers. It does seem, however, that many investment banks and big money centre banks have survived multi-billion write-downs of loans improvidently made, and that the steps engineered by Treasury Secretary Hank Paulson and Fed Chairman Ben Bernanke to shore up the financial system have prevented systemic failure.

We know that the housing market remains depressed: prices are falling, foreclosures are rising, and inventories of unsold homes remain high. Some analysts are encouraged by declines in the rate of decline in prices and sales, but they are a distinct minority. Perhaps we will know more when the newly enacted legislation to boost the housing market begins to make itself felt in the final quarter of the year. That might give the NBER gurus the information they need to decide whether to call what is going on “a recession”.

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