

ECONOMIC NEWS UPDATE

Irwin Stelzer

18 February 2008

Beware the Bankers' Complaints

"Please sir, can I have some more," whine the Oliver Twists on Wall Street. More interest rate cuts from the Federal Reserve Board's monetary policy committee, a bigger portion of stimulus from the President and Congress, more direct relief for the housing market, a bail-out of bond insurers -- you name it, and investors and bankers want more of it. Except for write-downs: the increased recognition of losses that nervous auditors are demanding is the one thing the bankers don't want any more of piled onto their plates.

This desire for more doesn't result from any recent period of deprivation: year-end bonuses, although frequently paid in bank shares rather than cash, have been relatively generous. Rather, it is that toilers in the financial services sector see lean times ahead, with the current round of lay-offs accelerating, and the value of their homes, especially second homes, dropping.

Worse still, the US economy seems to be in dire shape. Desmond Lachman, an economist at the American Enterprise Institute, expects "a more painful recession and one of longer duration than the 9 months characterizing the average post-war recession," rather than one that is "relatively mild by historical standards", as Goldman Sachs' economists are predicting. Treasury Secretary Hank Paulson says "the worst is just beginning" in the subprime mortgage market. "More Economists Signal Recession", headlines The Wall Street Journal.

Nor will the rest of the world be unaffected by America's woes. The Financial Stability Forum (a group of leading central bankers) expects "further shocks ... a prolonged readjustment which could be difficult." And the Governor of the Bank of England, Mervyn King, warns that struggling City bankers will have lots of company because all of Britain will experience a

“genuine reduction in our standard of living.”

We know three things, or think we do. The first is that credit is more difficult to come by, both for businesses and consumers. Not because interest rates are unattractive to borrowers, but because lenders have gotten pickier about whose IOUs they are prepared to accept. Second, we know that the housing sector is in almost terminal disarray, with foreclosures and inventories of unsold units rising, and prices falling. Finally, we know that the US economy is, at minimum, slowing, and possibly already in recession. Hence the investment bankers' demands for “more”: Ben Bernanke must cut interest rates, and the President must meet the demands of senate Democrats to enhance the \$168 billion stimulus package he signed last week.

Really? Consider each of those certainties in turn. To those who moan about a credit crisis Warren Buffett, the legendary sage of Omaha, has this to say, “Money is available and it's really quite cheap.” What he calls the “dumb money” might have stopped chasing risky investments, but cash is readily available for sound deals and to sound creditors.

As for the housing market, it is not at all clear that the problems are as severe as they have been made to seem. Yes, builders have built more homes than the market can now absorb. But interest rates are falling, government agencies have gained permission to be more active in the mortgage markets, lenders have agreed to renegotiate terms with hard-pressed subprime borrowers, and many local markets are doing quite well. Indeed, the widely reported house-price indices

that are producing so much talk of price collapse are so imperfect that Charles Calomiris, an economist at New York's Columbia University, says that “Housing prices may not be falling as much as some economists say they are.” One index shows a decline of 4.5% between the third quarters of 2006 and 2007, while a similarly constructed and equally well-regarded index shows a rise of 1.8% in house prices across the nation in that period, leading Wall Street Journal economist David Wessel to conclude that “puzzles remain”.

Finally, we come to the question of the condition of the US economy. Most economists and Wall Street analysts differ only between those who say a recession is already underway, and those who say we have hit a period of zero growth. All, or almost all, seem to agree that hard times are here, that the overly indebted consumer has taken or will soon take to the sidelines, that businesses will as a consequence begin laying off staff and cutting expenditures.

But who are we to believe -- the economists and pundits who see gloom and doom, or the businessmen on the sharp end of the economy, producing and selling things? Jurgen Hambrecht is CEO of BASF, a giant manufacturer with 90,000 employees and sales of well over €50 billion, garnered by selling hundreds of thousands of products to a wide variety of industries. He tells the press that he does not foresee a US recession, and that “I am glad to say that business in general does not show the panicking approach of the financial industry.... I am sleeping well at night.” Hambrecht is not alone. Executives at General Electric, Honeywell, Procter & Gamble, Kraft Foods and the owner of this publication, News Corp, are among the many who claim that their

businesses have never been better, that sales and profits are up, and that bookings are strong. The more cautious add, “so far”.

If the economy is indeed stronger than high oil prices, housing woes, and slower job growth would lead us to believe, and if inflation is the looming threat that it increasingly seems to be, perhaps policy makers would do well to turn a deaf ear to the bankers who clamor for “more”. Better to stand pat until recent rate cuts and the new stimulus package take effect later this year.

A version of this Update appeared in The
Sunday Times (London)