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ECONOMIC NEWS UPDATE

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Jobs, Car and Other Bad News

Now we know what it must have been like for the manager of a Soviet steel mill when called before Joe Stalin to explain why he had not met his production quota. We know that not because we have gained access to still-secret Russian archives, but because we watched top automaker executives abase themselves before congress in an attempt to get \$34 billion in emergency loans, in addition to the \$25 billion already promised to subsidize the development of greener vehicles.

First comes praise for the leader. The executives began by thanking congress for guiding them in the preparation of their long-term restructuring plans. Second comes signs that contrition is real. The executives will work without pay -- well, for \$1 per year -- and sell off their corporate jets. Third come excuses. No, it was not bad management but the decline in sales that brought out the begging bowls. Finally, veiled threats --

workers will be laid off, families will turn against the government, the entire economy will be adversely affected unless the loans are made -- and in the case of GM and Chrysler within the next few weeks.

Uncle Joe probably puffed his pipe, smiled, and had the manager shot; congressmen huffed and puffed, preened before the cameras, and will dole out enough money to tide the companies over until the new president and congress are installed next month. After that, bail-out cash will come in installments, with the companies required to meet performance targets to keep the cash flowing.

Which is only the latest indication that power has shifted from New York to Washington, from bankers and markets to congress and the president. Consider only the saga of Treasury Secretary Hank Paulson, who came to Washington after a stint as chief of New York-based Goldman Sachs, a firm now

reporting billions in losses after abandoning its investment-banking business model in favor of status as a government-sheltered commercial bank. Once the man who raised private-sector capital from his perch atop a Wall Street skyscraper, he is now the man who distributes billions in taxpayer funds to private-sector businesses from his perch at the Treasury.

If the display of forelock tugging by once-mighty Detroit industrialists is not depressing enough, there are reports from all parts of the world to add to America's gloom. On the international scene, Islamic terrorists slaughter innocent people in Mumbai, targeting especially Brits, Americans and Jews; Vladimir Putin shreds the Monroe Doctrine by sailing his ancient warships into South American waters; Angela Merkel, leader of Europe's largest economy, decides she is not enthusiastic about joining a worldwide stimulus effort; China adopts the beggar-thy-neighbor policy of guiding its currency down in order to support its export industries; and parts of Africa remain killing grounds.

On the national level, the economy has lost almost two million jobs this year -- over half-million last month alone. Only the decisions of thousands to leave the labor market has kept the unemployment rate from rising to more than 6.7 percent (from 6.5 percent). House prices continue to decline, share prices engage in nerve-jolting gyrations, millions more Americans rely on food stamps, and retailers gird for a Grinch-dominated Christmas, with such sales as are rung up being made at profit-destroying discounts.

The Federal Reserve Board's recent summary of business activity

reports that "overall economic activity weakened across all Federal Reserve districts..." Retail sales are down, "tourism spending was subdued... reports on the service sector were generally negative... manufacturing activity declined ... new orders were soft ... commercial real estate declined ... lending contracted...". For a fuller dose of gloom, look at the latest report from the Institute of Supply Management: service-sector activity is at its lowest level since the survey began in 1997, and manufacturing activity is at a 26-year low.

Federal Reserve Board chairman Ben Bernanke did nothing to dissipate the gloom when he summarized the condition of the housing market for a conference on housing and mortgage markets. Some 15%-20% of borrowers find themselves "under water" -- the outstanding amount of their mortgages exceeds the reduced value of their homes. One-in-five subprime mortgages are "seriously delinquent". By year end, 2¼ million homes will have been repossessed by lenders. Throw in a sharp drop in the construction sector, and the picture is one of unrelieved gloom.

Well, almost. But it is not yet time to pull the covers over our heads and refuse to get out of bed in the morning. Petrol prices have fallen from \$4 per gallon to less than \$2, and some experts are predicting further falls to \$1 by year end. Every \$1 drop adds about \$140 billion annually to consumers' buying power. Perhaps more important, the Fed's decision to purchase as much as \$600 billion in mortgage-backed securities has driven mortgage rates down and led to a spurt in refinancing applications and in applications for financing of new home purchases. The

Mortgage Bankers' Association says mortgage applications rose by the largest amount since it began compiling records in 1990.

Other credit markets should also ease a bit when the Fed begins to purchase \$200 billion in securities backed by student loans, car loans, credit-card debt and small business loans. Indeed, there is some reason to believe that credit markets are calming down.

But there just isn't enough silver around to line all of the clouds that are in clear view. At least not just now. But in the longer term the outlook might, just might, be brighter. Much will depend on whether recent government involvement in what was the private sector proves to be permanent. If so, we will have such paragons as New York Senator Charles Schumer telling the auto companies what sort of cars to make -- his taste runs to battery-driven hybrids that run only 40 miles without a charge and are so expensive that they require large subsidies to make them even marginally acceptable to consumers. Or other politicians telling the banks that now benefit from government funds just how to allocated capital, with lower-income Americans and politically well-connected businesses the most likely beneficiaries.

If politicians remain in the saddle and ride the private sector, the entrepreneurs who have powered America's growth in the past will be displaced by lobbyists with access to the government honey pot. Bad news, that.

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