

ECONOMIC NEWS UPDATE

Irwin Stelzer

13 November 2008

Washington Cheers, The Nation Groans.

London-to-Phoenix-to-Washington does more than throw one's body clock into a spin. It is disorienting. The gloom in London is thicker than the fogs of yesteryear, and the Prime Minister is trying to avoid culpability for his nation's economic woes by blaming the its and indeed the world's problems on the US, while assuring the nation that he has the entire world financial crisis under control. Or would, if only the Saudis and the Chinese would cough up billions in cash to match the few farthings Brown has available to contribute to a coordinated global stimulus package.

In Phoenix, the home of John McCain and many of his very conservative supporters, the gloom seems even deeper. Not only are the voters there attempting to adjust to a president-elect who shares neither their social values (many I spoke with are buying guns because they expect Barack Obama to make such purchases illegal) nor their economic philosophy,

but they are living on the sharp edge of the emerging recession. The Arizona economy depends heavily on the real estate market, and to say that market is depressed is to understate the perceived problem. The construction industry is so slack that many of the Mexicans who came across the border to work on construction products can't find even low-paid work, and so are headed home.

Then to Washington, a majority-black city, and heavily Democratic. Euphoria reigns. Construction cranes are everywhere, and although the property market is softer than in the past, commercial space is being readied to house the growth in government that is inevitable when the president-elect and his activist team takes over. And that means jobs for the private sector lobbyists, lawyers and hangers-on who inevitably attach themselves to a new administration in the manner of the sandpipers who inhabit the backs of hippopotamuses in Serengeti National

Park. Lobbyists are particularly frantic: all save \$60 billion of the \$350 billion initial spending authorization has been spent, and, as The New York Times described the "mad scramble", "The Treasury Department is under siege by an army of hired guns for banks ... and insurers - as well as from improbable candidates like a Hispanic business group representing plumbing and home heating specialists." Then there is the "Fix Housing First" group that wants mortgage rates lowered to 2.99% and a \$22,000 tax credit for new buyers.

Real estate agents are also eagerly awaiting the arrival of the 3,000 Democrats whose jobs are within the gift of the new administration. They will sop up some of the excess inventory, especially in the posh Georgetown section favored by liberal politicians and bureaucrats.

The Obama transition team knows better than to join in the local glee. The economy continues to deteriorate, and at a rapid rate. Consumers have finally gotten the message that credit cards are not the same as cash, and are cutting spending, forcing retailers to offer deep discounts, to no avail as October sales plummeted. Neiman Marcus (-28%) Saks (-17%), J.C. Penny (-13%) and Kohl Corp. (-9%) tell reporters that "customers just weren't walking through the door." Only Wal-Mart's sales were up, by an unexpectedly large 2.4%.

The number of workers whose jobs have disappeared has risen for ten consecutive month, and the number unemployed for more than 27 weeks continues to rise. House prices continue to fall, and buyers who dipped a toe in the water in recent months are canceling their contracts in record numbers. Share prices show little sign of

having touched bottom. And General Motors, which is burning cash at the rate of \$2.3 billion (not million) per month, will be broke early in the new year.

The Democrats, for whom the United Auto Workers (UAW) delivered the key state of Michigan, are calling for a bail-out, and now. The Bush administration would like to leave that chore to president-elect Obama. And with reason. GM was losing money even in good times, and there is no reason to believe that \$50 or so billion will enable it to survive long-term. Taxpayers can't be delighted at the prospect of having their hard-earned money used to prevent demands on the unions for some give-backs. A study by the Center for Automotive Research found that UAW compensation is 68% higher than the average for the U.S. manufacturing sector. And some 40 million American taxpayers who do not have health insurance, some because they can't afford it, are not pleased at the prospect of watching their tax dollars finance the lavish health-care plan that the UAW extracted from a compliant General Motors in the good old days when all costs could easily be passed on to consumers. Remember: the laid-off workers in the so-called "jobs bank" get full pay and benefits even though they have been laid off, and CEO Rich Wagoner, who is presiding over this unfolding disaster, was paid \$14.4 million last year. Add all of this up and the argument for a bail-out seems to be, er, thin. But politics trumps economics, so Obama, Pelosi and company will in the end reward the UAW for its support.

This might turn out to be the conservatives' line in the sand. They will argue that allowing GM to go bankrupt would enable the courts to order changes in the company's onerous labor

contracts. Meanwhile, just as the airlines continued to fly while in bankruptcy, GM could continue to produce such cars as it might be able to sell.

There is a bit of cheer from credit markets. Several of the policy initiatives in place have eased the credit crisis. As Federal Reserve Board Governor Kevin Warsh -- a private sector banker in an earlier life, and no mere academic or bureaucrat -- pointed out last week:

[We have had] a forceful response from monetary, fiscal, and financial policymakers. There are some notable signs of improvement. Short-term funding spreads are retreating from extremely elevated levels. Funding maturities are being extended beyond the very near term. Money market funds and commercial paper markets are showing signs of stabilization. And credit default swap spreads of banking institutions are narrowing significantly.

This doesn't mean that credit markets are about to return to normal -- whatever "normal" is. But remember: the policies adopted have not had time to work their way through the economy. Worse still, Treasury Secretary Paulson is changing his position on the use of funds almost daily -- better than persisting in error, but off-putting to those who suspect that further changes are in store when Obama's secretary of the treasury allows Paulson to return to his bird-watching. And turns his attention to the so-called real economy, which economists at Goldman Sachs

expect to contract at an annual rate of 3½% this quarter, with unemployment rising from 6½% to 8½% by the end of next year.

[ET

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