

ECONOMIC NEWS UPDATE

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Will the Economy Respond to All the Medicine Being Administered?

One team of ecomedics has done what it can. Ben Bernanke's Federal Reserve Board monetary policy gurus dropped its short-term interest rate another 0.25 percent last week, to 2.0 percent, and told its patient, the US economy, not to look for still another shot in the arm. We might do more for a few patients, since the banks in our care seem to be suffering from a reduced ability to function normally, but that is about it.

The other team has finally begun to distribute part of the \$170 billion of medication it prescribed some months ago. The first doses were deposited last week in the bank accounts of the 7.7 million taxpayers who have

direct deposit arrangements; paper checks will begin to arrive this week in the mailboxes of the 130 million Americans eligible for this Christmas-in-May-June-July. Individuals will receive up to \$600, and couples filing joint tax returns up to \$1,200, with families getting an additional \$300 per child. Individuals earning more than \$75,000 per year, and couples with incomes above \$150,000, will get less.

Economists demonstrated the precision of their forecasting tools by providing a range of estimates of the impact of the stimulus package. Some say that recipients will save the money, or use it to pay down overdue credit

card debt, and to pay for almost-\$4 gasoline, leaving little to spend on new purchases. And, they add, much of what is spent will have little impact on the US economy: it will go to buy stuff made in China and other countries that have come to dominate the American market.

Other economists are more optimistic. The National Retail Federation expects consumers to pump \$42.9 billion into shops, boosting retail sales by a significant 1.5 percent. Retailers are ready to help consumers spend their windfall. Sears and Kmart, among others, will add 10 percent to the value of checks that are converted into gift cards. Wal-Mart, which took in 25 percent of the 2001 rebate, will cash checks at its 3,500 stores with no charge for the service. Because rebates are aimed at lower-income households, discounters expect to be the principal beneficiaries if consumers do indeed part with a significant portion of their stimulus checks.

That's not what the nation's charities want to see happen. Many are urging Americans to use at least part of their rebate checks to make life better for the less fortunate. They reckon that 5 percent of the people receiving checks will donate a portion to charities, with the potential take coming to \$5.2 billion. Charities

are promising to spend every cent they get, stimulating the economy.

If the doctors at the Fed and the White House don't revive the patient, congress is concocting still another treatment. Details are still being worked on, but when they are agreed between the House and the Senate, and a reluctant White House signs on, billions will be headed towards the mortgage markets to help troubled homeowners, and towards home builders to help get them through what is one of the toughest periods they have ever faced.

All of these ministrations will have one of three effects. They will enable the patient to avoid sinking into real sickness, and maintain its current weakened condition, dragging along from quarter-to-quarter in subpar health, until its in-built body mechanisms restore it to complete health. That's what seems to be going on now: latest figures show that the economy might well be holding its own, and the jobs market might not be weakening very much, as employers outside the financial and housing sectors struggle to avoid laying off valuable employees.

Or these remedies will have no effect, and the patient will become really ill: the economy will lapse into recession. That is what most Americans seem to be expecting. Consumer confidence

is down, and almost three-out-of-four Americans think the country is on the wrong track. They have no confidence in the President's management of the economy, see no end to high gasoline prices, downward pressures on the value of their homes, and rising health care costs.

There is another alternative. All of this medicine might just restore the economy to health. It is being administered at just when boosts of this sort have their greatest effect -- when things are getting a bit better.

The banks have begun to shore up their balance sheets. In April they took advantage of improved investor sentiment to sell \$303 billion of bonds, the third-highest month of all time. They had already raised some \$40 billion in new capital in recent months, and sold off \$160 billion of the \$250 billion of highly leveraged loans made in connection with buy-out deals. These funds didn't come cheaply, but they did come.

Non-financial companies also returned to the market: investment grade non-financial companies issued a record amount of bonds last month. All of this has brought cheer to stock markets.

But economists are never satisfied with good news. They now worry that things might get

too good too soon. Critics, among them some of the most reputable economists in the country, say the Fed has sown the seeds of future inflation. They point out that lower interest rates have resulted in a depreciation of the dollar, and a flight from dollar assets into commodities such as oil and copper, which is why their prices have soared. Cheap money means dear commodities. That's why last week's hint from the Fed that it is unlikely to lower rates further buoyed the dollar, and led to a sell-off in many commodities, including oil.

Confused? Don't be. Just read the warning on the medications prescribed by economists: "The effects of this nostrum are uncertain and will vary depending on circumstances we cannot now foresee."

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