

McClatchy Washington Bureau

At 13 months and counting, no one sees end to recession

By Kevin G. Hall | McClatchy Newspapers
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WASHINGTON — Now that the U.S. economy officially has been in recession for a year, it's certain that this downturn will be deeper and more punishing than the past two, in 1990-91 and 2001. That makes it harder to gauge where the end may be and what's necessary to restore the world's largest economy to health.

Falling home prices, a deep freeze on lending and turmoil in financial markets all helped create the current recession, which started in December 2007. Friday's grim jobs report, with employers shedding another 533,000 positions in November, was an exclamation point for a worsening recession.

The credit crunch, falling home values and shaken consumer confidence all hurt consumer spending, which drives two-thirds of all economic activity. There's no quick or easy way to turn them around, especially at the same time.

Since the end of World War II, there have been 10 recessions before this one. The bust of 1973-75 followed oil-price shocks and failed attempts at government price controls. The skid of 1981-82 was triggered by high interest rates needed to quash runaway inflation and a banking crisis rooted in a real-estate crash. Those were the two worst recessions in the postwar era, and each lasted 16 months.

Another real-estate and banking crisis led to the recession of 1990-1991. Later that decade, overvalued technology stocks collapsed and sparked the 2001 downturn, which lasted eight months.

"All recessions start with the economy trying to absorb an economic loss associated with the correction of previous excesses. The last three are similar in that the private sector provided some excesses," said Vincent Reinhart, a former top economist at the Federal Reserve. "In this case, as opposed to the previous ones, (financial) markets amplified to a remarkable extent that economic loss."

Today's recession was brought about by a rapid growth in home prices and home construction that was unsustainable. Under normal circumstances a price correction would occur and the economy would quickly return to growth. That's why the average length of recessions since 1945 has been 10 months.

These aren't normal times, however. The U.S. economy is entering its 13th month of recession, and no one sees an early end.

"It's going to be a longer recession than any in the postwar period, because I don't think we will get out of it before the middle of 2009," said Lyle Gramley, a former Federal Reserve governor from 1980 to 1985. "The primary reason we're going through this is we have a credit crunch that is literally strangling the economy."

His view is widely shared.

"We continue to believe that this will be the longest and, possibly, the deepest recession of the post-war era. If the recession runs through May 2009, this will qualify as the longest recession since the 1930s," John Ryding and Conrad DeQuadros, partners in the New York research firm RDQ Economics, said in analysis for investors.

Unemployment hit its highest postwar peak — 10.8 percent — in 1982. Today, it's 6.7 percent and rising fast.

If there's agreement that this recession will be long and deep, there's also consensus that a stimulus plan will be needed to jolt the economy back to life.

"Only a concerted, comprehensive and consistent policy response will bring this downturn to an end by this time next year. This response should include a zero effective funds rate and quantitative easing by the Federal Reserve, a large foreclosure mitigation plan, and a big economic recovery package," said Mark Zandi, chief economist of Moody's Economy.com, a forecaster in West Chester, Pa.

President-elect Barack Obama has signaled that he'll push a massive economic stimulus plan that's expected to include a middle-class tax rebate, big spending on public works projects to create jobs and aid to states.

"My guess is the fiscal-stimulus package is going to be very large, a package spread over two years that will total at least \$700 billion over those two years, front loaded to get big" results fast, said Gramley, now an adviser at the Stanford Washington Research group in Washington.

The stimulus is needed to create jobs. During the Great Depression, one in four Americans was unemployed. The current recession has seen almost 2 million jobs lost, but remains more than 2.2 million jobs short of the depth of layoffs seen during the early 1980s.

To turn things around, the plunge in consumer confidence must be halted.

"Once the consumer stops spending, you get this vicious circle. A decline in consumer spending leads to declining business spending. Factory operating rates fall," said Daniel Meckstroth, chief economist for the Manufacturers Alliance/MAPI, a trade group for U.S. manufacturers. "What has to be done, someone has to make up for this lack of demand — someone or some act."

The worst is still ahead, he warned, because business spending and commercial construction are poised to fall dramatically in 2009. Following this year's sharp drop in consumer spending, he said, "the other shoe is about to drop."

Economists think that the Federal Reserve, which has been bold in attacking problems in credit markets, is about to become even more aggressive in stimulating the economy. It's widely expected to cut its benchmark lending rate below the current low 1 percent rate when Fed governors meet on Dec. 16.

That would drive the cost of borrowing money for banks to almost zero. Some economists think that the Fed may also begin purchasing Treasury debt in an attempt to knock down all

sorts of lending rates to consumers and businesses that are set based on the yields of Treasury bonds and bills.

"When you make money free, or virtually free, there's got to be some projects that are viable," said Meckstroth, who doesn't believe the manufacturing sector will return to growth until 2010.

External factors will also be important in ending the recession. Usually a U.S. downturn doesn't correspond with a recession in Europe or Japan, but this time they do.

"The business cycles don't coordinate, but this time they are international. In this sense, this downturn is worldwide," said Harry Veryser, the director of graduate economic studies at the University of Detroit and an expert on business cycles. "This means it's going to be hard to get out of it by exporting."

U.S. exports of manufactured goods and farm products have helped moderate the U.S. downturn for much of this year.

Then there's the China factor. China is a key market for the world's goods and services. Its growth is sure to slow, but if its drop in growth is steep, the global slowdown will deepen, making U.S. recovery harder.

"I think the aggressiveness of policy (solutions) is going to limit the depth of the outright recession, but that doesn't mean that the recovery won't take awhile," said Reinhart, the former top Fed economist, now a commentator for the American Enterprise Institute, a conservative policy group.

Bad as things are, some analysts suggest that things aren't as bad as advertised.

"If you look objectively at the current economy and factor out what is read, written, and spoken about, you see a mild recession, which is not good for people, but modest can be almost predictable" said Brian Hamilton, the chief executive of Sageworks Inc., a data-research company in Raleigh, N.C.

His is a minority view among analysts.