The Indy economy

by the St. Louis Post-Dispatch

Watching the American economy these days is like watching an Indiana Jones movie: Real estate bombs explode, pillars of banking totter, investors duck for cover. Yet, so far America has come through it all with only a few bumps and bruises.

It's a remarkable performance, and chances are that it will continue.

Federal Reserve Chairman Ben Bernanke went before Congress last week and predicted that the American economy will slog along sluggishly through early next year. But he thinks we'll avoid a recession.

Heaven knows he has things to worry about. Oil prices are near $100, housing prices are falling, big banks are losing billions and the dollar is performing a belly flop.

Yet our globalized, highly productive, technology-heavy economy has so far refused to yield.

Gross Domestic Product grew at a very healthy 3.9 percent clip from July through September, and that figure could well be revised upward. This happened despite a nose dive in the housing industry and August's crisis in the credit markets.

The nation is still adding jobs at a reasonable clip - 166,000 in October - and unemployment is at a balmy 4.7 percent. That's why consumers keep spending freely, even as the prices of homes slip lower.

But bad news is still piling up. No one yet knows how deep the losses on subprime investments will sink. Lenders have already tightened up on mortgages and loans to corporations with less than solid finances. But here's the big worry: If subprime losses cut too deeply into banks' capital, they'll have to restrict lending even to credit-worthy customers. That would toss a monkey wrench into the economic engine. We're not close to that point yet, but it's a possibility.

Oil prices are a double-whammy. Gas at $3.08 per gallon gas causes consumers to spend less money, slowing growth. It also adds to inflation.

That's the Fed's other major worry. Once inflation gets going, it's very hard to stop, as we saw in the 1970s.

Core inflation has been dropping this year, and prices are up a tame 2.1 percent from last year. The Fed is loath to see that trend reverse.

That gets us to our sinking dollar, which both helps and hurts. The less-than-almighty buck is down 36 percent on a trade-weighted index against major currencies since 2002.

A lower dollar can tempt importers to raise prices. So far, importers are holding the line in order to keep their market share. Core import prices are up only 2.4 percent over the year. But they won't hold out forever.

Meanwhile, the weak buck is boosting exports of U.S. goods by an estimated 8 percent this year. That keeps American factories humming, erasing part of the impact of the housing recession.

All this has the Fed's Bernanke performing like Indiana Jones on a tightrope. The Fed has cut interest rates twice since September in an effort to keep the economy rolling and ward off a credit crisis.

But if Bernanke cuts further, he risks restarting inflation once the economy finally revives. Lower rates also torpedo the dollar.

Bernanke told Congress that the economy should slow "noticeably" now, remain sluggish early next year, then recover on its own. In other words, no recession. We bet he had his fingers crossed.

Reprinted from the St. Louis Post-Dispatch - CNS

The Indy economy by the St. Louis Post-Dispatch