Economy: From boom to doom?

by the St. Louis Post-Dispatch

The Labor Department reports that the nation lost 63,000 jobs last month, after losing 22,000 in January. Those numbers are the clearest sign yet that the nation might be in recession.

Put the emphasis on "might." When a recession gets rolling, job losses tend to be much worse. In the 2001 slump - which was mild by historical standards - monthly job losses hit 325,000, and stayed above 100,000 for nine months.

We're not at those levels yet and we may not get there, but the trend is scary. There is great disagreement over how scary things will become, ranging from "the Fed and Congress will save the day" to "consumers will doom us." Best advice: Take a deep breath and try to relax.

The current mess started with the popping of the housing price bubble and rising foreclosures, mostly because of risky subprime loans. Banks and investors lost tens of billions of dollars in the subprime mortgage meltdown. Some may not survive.

That set off an anxiety attack in the credit markets. The reaction is clogging up some mid-sized arteries in the great circulatory system of money that many financial institutions and other corporations rely upon.

Frightened banks and other lenders tightened up the credit spigots. Lots of marginal companies that could have borrowed money last year can't today.

Meanwhile, many consumers no longer can use their home equity as a ready source of cash, while others are struggling just to hold on to their houses. Consumer spending still is rising, but slowly.

The optimists hold that all this will pass away without a real recession, defined as two quarters of falling gross domestic product. The Federal Reserve has cut short-term interest rates by 2.25 percent since summer, and Chairman Ben Bernanke virtually has promised more cuts to come. The Fed also is pumping money into the banking system - $200 billion on Tuesday - to stop the financial arteries from further clogging up. Fed intervention usually takes six months to a year to show an effect, but on Tuesday Wall Street reacted immediately. The Dow Jones Industrial Average was up 416 points, the biggest one-day gain in five years, on news that the Fed would allow banks to use mortgage-backed securities as collateral for its $200 billion in new money.

Meanwhile, unemployment remains under 5 percent and consumers still have healthy paychecks. Those paychecks, not home equity, are the major force in consumer spending. And spending should get a very timely boost in May, when rebate checks start arriving as part of the stimulus plan passed by Congress.

The bad news scenario focuses on consumers, who power two-thirds of the economy. Washington University economist Steven Fazzari notes that the average consumer now spends all he earns, up from only 88 percent a quarter century ago. He's deeper in debt than ever. His family is about spent out and can't take any more financial stress.

Consumer spending is "threatened by its evil twin - the explosion of household debt," he wrote along with co-author Barry Cynamon of the University of Chicago. Their worst-case scenario:

"The U.S. may have exhausted an unprecedented consumption-driven boom and may sit on the brink of the most severe downturn in economic activity since the early 1980s, and possibly since the Great Depression,"

The views of Fazzari and Cynamon, we should hasten to say, are not widely shared. We hope it stays that way.

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