

Popular Economics Weekly

WEEK OF NOVEMBER 13, 2006—DO WE MENTION THE ‘R’ WORD?

Is a recession—that ‘R’ word—coming? Chances are, we won’t know until after the fact. The National Bureau of Economic Research (at [www.nber.org](http://www.nber.org)) is the semi-official arbiter of business cycles and denotes when recessions begin and end. Its Business Cycle Dating Committee declared on July 17, 2003 that the 2001 recession ended in November 2001, 2 months after the 9/11 attacks. We have now had 5 years of a sometimes topsy-turvy economic recovery, much longer than most, and so economists are wondering what the next downturn will look like.

How was the last recession determined, and when will we know if a new recession is in the offing? It could be much later, says the NBER, because the major indicators “are preliminary and subject to substantial revisions.” It is not always easy to identify the particular month of a peak or trough rapidly, in other words.

We already have several indicators showing slower economic growth, from declining real estate sales (Six Los Angeles counties just reported a 22 percent sales drop.), to slower Gross Domestic Product (GDP) growth, lower industrial production and subpar payroll jobs creation.

The declared end of the 2001 recession was just such a case. Its own press release explained some of it: “In determining that a trough occurred in November 2001, the committee did not conclude that economic conditions since that month have been favorable or that the economy has returned to operating at normal capacity. Rather, the committee determined only that the recession ended and a recovery began in that month.”

We all know the stock market crashed in 2000-01, and the economy didn’t pick up steam until 2004. The Federal Reserve also began to drop interest rates Jan. 2001 in concert with the federal tax cuts, alarmed that we could have a serious deflationary recession, as had happened in Japan in the 1990s.

We have a completely different scenario today. Interest rates are rising and home sales falling, which is why many economists say we may not be so lucky. Also, we had a record budget surplus in 2000, whereas it is a record deficit today, leaving little room for more fiscal stimulus (i.e., government spending).

On the other hand, it doesn’t look like a new stock market bubble is in the offing—price-to earnings ratios are at historical averages—and rents are beginning to catch up to real estate values, a sign that the housing market is self-correcting. Inflation is also on a downward slope, led by falling energy prices.

PPI—Wholesale prices plunged across the board in Oct. The 1.6 percent decline matched the record low set during the 2001 recession. Finished goods’ prices—those closest to retail—have now fallen 1.6 percent in a year.

CPI—Consumer prices fell 0.5 percent, and are up just 1.3 percent in 12 months, the slowest inflation rate since 2002 thanks to falling energy prices. That means real weekly

wages are now increasing—1.3 percent in Oct., and 3.2 percent in the past year after inflation. Retail energy prices plunged 44 percent in the past 3 months, alone.

**RETAIL SALES**—Sales fell for the second consecutive month in Oct., igniting fears of a not so merry Christmas for retailers and with it lots of merchandise discounting. Walmart and Target are in a virtual price war, say analysts.

Another beacon of hope is that mortgage refinance applications rose to the highest level in more than a year, reports the Mortgage Bankers Association for the week ending November 10. This is in part because of falling interest rates. The 10-year benchmark Treasury bond yield is now 4.6 percent, and means that we have a steeper slope to the inverted yield curve. Long term interest rates are currently almost 0.75 percent below short-term rates.

So the case for a recession really rests on the housing pessimists, who predict even larger job losses next year in housing-related areas like construction, insurance, and other financial services. The most vocal has been Pimco Bond Fund Managing Director Paul McCulley, who believes the housing market is already in recession. “The consensus at our September Forum was that the recession in the U.S. housing sector—and, yes, it is fair to call that sector in recession—will be nastier than expected, both directly in terms of residential investment and indirectly via the effect on consumption,” he said in his latest comments.

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