

Time to Face the Facts: The Economy Probably Won't Get Better For Quite a While

Brace yourself for very anxious and stormy times, economically and politically, because there's little prospect that the U.S. economy will improve for quite some time. The latest to weigh in is the Federal Reserve, whose new private forecast sees no growth in sight for the rest of this year and slow gains at best for 2010. The Fed always speaks cryptically (even among themselves). What it means is that the economy is still in free fall, with our best prospect for hitting bottom coming sometime this summer, and then bouncing around the bottom through the fall and into early winter. Why early winter? The only force out there to stop the decline is the stimulus package, which ought to kick in just about then. The Fed didn't say so, but their view that any recovery is some time off and will be a modest one reflects the judgment -- one I share -- that the administration's fixes for banking and housing aren't up to the task.

The Fed also didn't say so, but the outlook for much of the rest of the world is at least as gloomy, since so many Asian and European economies depend on Americans to buy what they produce and on U.S. businesses to invest in their countries. That's not in the cards for some time. Trade is falling at a 20 percent rate here, at 30 percent rates across much of Europe, and at 30 to 40 percent rates in much of Asia. This week, for example, we found out that Americans' purchases of foreign imports in February were down \$62 billion from a year earlier. That translates into tens of thousands of jobs lost in a lot of other countries (and ultimately fewer U.S. exports down the line).

The Fed's view should be a wake-up call for the administration, which still talks about a "V" shaped business cycle, where our deep decline will be followed by a strong and sharp recovery starting late this year. V-shaped recoveries are powered by unleashing suppressed demand: People cut back until they see the light at the end of the tunnel, and then they buy everything they had put off during the recession -- especially houses and other large purchases that require credit. That's the scenario behind OMB's risible forecast of more than 3 percent growth next year, followed by two years of more than 4 percent gains.

This misunderstands the very nature of what we're going through, which is nothing like the other recessions of the last 50 years. This time, the economy's circulatory system, banking and credit, isn't working. Even if it were, American households aren't holding back because their wages are down a bit. They're being forced to downsize for the long term, because this crisis has wiped out 20 percent of their net worth. It's even more serious than that, because most Americans used the fast-rising net worth they thought they had over the last decade to support their consumption. Mainly, we withdrew trillions of dollars from the once fast-rising value of our houses so we could go on vacation, buy new furniture, and send the kids to college. We had to do that, because for the first time in more than a half-century, most people's wages and incomes stagnated during a "strong" expansion.

The current crisis will pass eventually, even as it takes much longer and exacts much larger costs for tens of millions of people than any downturn since the 1930s. When it does, the administration and the country will face once again the profound structural problem of the last decade -- of most people's incomes stagnating in the face of strong productivity gains, and relatively little job creation during times of strong GDP growth. Addressing that will require all of the President's skills, because it won't change unless we slow down rising health care and energy costs, and educate and train everyone in many of the ways we now use to prepare only the top 20 percent of us.

The irony is that if President Obama can put in place policies for banking and housing that would work better than what his advisors have been willing to put out there so far, the economy could recover decently early next year. Then, he could have the political capital for the rest of his agenda, which is targeted just where it should be, on health care costs, energy, and education and training. But if he doesn't pull off the recovery, none of the rest will happen -- and the Obama years could look a lot like the Bush era.