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2010: "The Year of Severe Economic Contraction"

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Upbeat reports in the financial media, belie the effects of the ongoing credit contraction. Massive injections of central bank liquidity have prevented the collapse of financial markets, but have done little to ease the deleveraging of households or stimulate activity the broader economy. The crisis has stripped $13 trillion in equity from working families who now find their access to credit either cut off or severely curtailed by the same banks that received hefty taxpayer-funded bailouts. The fiscal strangulation of the millions of people who are no longer considered "creditworthy" is progressively weakening demand and spreading pessimism across all income levels. Growing public desperation was the focus of a special weekend report by Bloomberg News:

"Americans have grown gloomier about both the economy and the nation's direction over the past three months even as the U.S. shows signs of moving from recession to recovery. Almost half the people now feel less financially secure than when President Barack Obama took office in January, a Bloomberg National Poll shows.

The economy is the country's top concern, with persistently high unemployment the greatest threat the public sees. Eight of 10 Americans rate joblessness a high risk to the economy in the next two years, outranking the federal budget deficit, which is cited by 7 of 10. An increase in taxes is named as a high risk by almost 6 of 10.

Fewer than 1 in 3 Americans think the economy will improve in the next six months….Only 32 percent of poll respondents believe the country is headed in the right direction, down from 40 percent who said so in September." (Bloomberg)

The near-delirious optimism that followed the 2008 presidential election has fizzled in less than 12 months. While the policies of the Obama administration have improved Wall Street's prospects for record profits and lavish bonuses, ordinary working people continue to fight to keep their jobs and maintain their standard of living. Recent data show that household debt which surged during the boom years is being pared back at a historic pace. Household debt to disposable income has plummeted from 136 percent to 122 percent in a little more than a year, leaving many families with little to spend at the malls or shopping centers.

Severe retrenchment has triggered a shift towards personal thriftiness which is reducing economic activity and strengthening deflationary pressures. 2010 is likely to be even worse, as mushrooming foreclosures and commercial real estate defaults force banks to slash lending accelerating the rate of decline. This is from Bloomberg:

"Foreclosure filings in the U.S. will reach a record for the second consecutive year with 3.9 million notices sent to homeowners in default, RealtyTrac Inc. said. This year's filings will surpass 2008's total of 3.2 million as record unemployment and price erosion batter the housing market…

Foreclosure filings exceeded 300,000 for the ninth straight month in November, RealtyTrac said today. A weak labor market and tight credit are "formidable headwinds" for the economy, Federal Reserve Chairman Ben S. Bernanke said in a Dec. 7 speech in Washington. The 7.2 million jobs lost since the recession began in December 2007 are the most of any postwar economic slump, Labor Department data show. Unemployment, at 10 percent last month, won't peak until the first quarter, Quigley said." (Bloomberg)

The Obama administration's $787 billion stimulus pushed GDP into positive territory for the first time in more than a year, but the maximum impact has already been felt. President Obama–under advice from his chief advisors– has shifted his focus from soaring unemployment to long-term deficits. Additional stimulus will be no more than $200 billion, of which, a mere $50 billion will go towards jobs initiatives. At the same time, Fed chair Ben Bernanke will terminate the quantitative easing (QE) program which kept long-term interest rates low while providing financing for the housing market. When the program ends, rates will rise, housing prices will tumble, and liquidity will drain from the system. The end of QE coupled with dwindling stimulus ensures that economy will slide back into recession in the 2nd or 3rd Quarter of 2010.

Policymakers have decided to create conditions that are favorable to financial sector consolidation and the further privatization of public assets. The economy is being strangled by design.

Here's economist Mark Thoma explaining why consumption will not return to pre-crisis levels:

"For the immediate future and likely for much longer than that, slow consumption growth is expected. One way that could change is if the government implements a successful jobs program or uses some other means to increase household income (e.g. a payroll tax cut), and households spend rather than save the extra income…, but the political environment makes a jobs program or further fiscal policy action highly unlikely.

Similarly…the Fed is anxious to unwind its massive policy intervention, not extend it, so monetary policy is unlikely to help much either. Since monetary and fiscal policy authorities are unwilling to provide further help, slow growth is the best outcome we're likely to get." ("Will Consumption Growth Return to Its Pre-Recession Level?" Mark Thoma, moneywatch.com)

Along with flagging consumption, economists Antonio Fatas and Ilian Mihov show why both investment and employment will not rebound in the way that many bullish analysts expect. By tracking the rate of recovery in the last 5 recessions, the two economists show that demand will remain flat for a prolonged period of time, precipitating a "jobless" and "investmentless" recovery. Their research supports additional stimulus to reduce the output gap and engage the labor force in productive activity. The administration's policies are the exact opposite of the majority of professional economists who believe that deficits need to increase to effect overcapacity and underutilization. Obama is deliberately steering the economy into a double-dip recession.

While financial institutions have been propped up with zero-rates, myriad lending facilities and boatloads of Fed liquidity, the real economy continues to on a downward path. As households rebalance accounts and increase savings, the signs of distress are becoming more apparent. In Europe, the ECB and IMF have begun to use the financial crisis to wrest control of the budgets of deficits-plagued nations to apply business-friendly austerity measures. The economic meltdown–that was generated by overleveraged banks trading dodgy investment paper–is now being used to assert corporate/bank control over sovereign nations. Greece, Ireland, Iceland, Ukraine, Latvia, Lithuania, Portugal and Spain are all presently in the crosshairs of neoliberal restructuring. Surely, the same policies will be applied within the United States under the guidance of supply-side economist and chief advisor to the president, Lawrence Summers. Thus, in 2010, economic contraction will continue to force state and local governmnets to lay off millions of more workers while public assets and services are made available at firesale prices to private industry.

Debt deflation and deleveraging will continue into 2011, while foreclosures, personal bankruptcies and defaults continue to mount. The public's frustration with ineffective government policies, is likely to change from pessimism to rage on short notice. The prospect of social unrest or sporadic incidents of violence can no longer be excluded.

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