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The Grim Reality of Economic Truths

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It is always good to know as a citizen that your leaders think everything is under control, for this reason I can only begin to imagine the relief people in the United States must feel when President Bush publicly acknowledges; "I believe that our economy has got the fundamentals in place.^{2} I must admit however that I struggle to understand where the president is getting his data from and I dread to think what things will look like by the time he admits that ^{3}fundamentals^{2} are not really ^{3}in place^{2}. According to Alan Greenspan "as of right now, U.S. economic growth is at zero^{2}, ^{3}home prices will continue to weaken^{2} and a boom in oil prices is going to "go on forever". As he puts it, the US is ^{3}clearly on the edge."

I remember the time when General Motors Corp. was considered a pillar of the American dream, a fundamental of the economic miracle. Now, after reporting a quarterly loss of $722 million, compared with a profit of $950 million a year earlier, and offering buyouts to all of its 74,000 United Auto Workers employees, GM is clearly not a part of the sound fundamentals which President Bush likes to describe. The same seems apparent with MGIC Investment Corp., the largest U.S. mortgage insurer, which posted a record quarterly loss of $1.47 billion and is also being kept out of the Œpresidential fundamentals equation^{1}.

Things are so bad in the United States that during the Senate Banking Committee hearing, Treasury Secretary Henry Paulson resorted to aliens from outer space to describe how things are looking; "If someone came down – a man came down from Mars – and you were trying to explain the regulatory structureŠ it's a patchwork quilt, in many ways." I don^{1}t blame him for looking for such far fetched metaphors when many economists and banking industry experts according to Time magazine, ^{3}believe the subprime crisis could metamorphose into the biggest debacle to hit the sector since the Savings & Loan catastrophe of the 1980s, which caused some $500 billion in losses to the banking industry." As Merrill Lynch economist Kathy Bostjancic elaborates ^{3}the impact here could be far larger (than the S&L crisis) in terms of the dollar amount and the spillover effects into other parts of the economy, particularly the consumer."

Doug Duncan, chief economist with the Mortgage Bankers Association, in his updated 2008 forecast says "the principal concern of the current credit crisis lies in the possibility that banks will eventually run out of capital," as Dean Baker, co-director of the Centre for Economic and Policy Research, a Washington think tank, adds, "the amount of debt that's likely to go bad is virtually certain to be in the high hundreds of billions of dollars, and it wouldn't surprise me if it ends up crossing a trillion."

In short, what we have here is the worst housing slump in a quarter century, an economy which in January alone lost 17,000 jobs, and The Standard & Poor's 500 Index which has fallen three consecutive months, the longest losing streak since 2003. We also have Americans whose December monthly expenditure on debt service, housing, medical costs, and food and energy bills has risen to an unprecedented 66.9 percent of their total spending, the highest since records began in 1980. According to Ron Blackwell, chief economist at the AFL-CIO, “American workers are suffering a generation-long decline in living standards and rising economic insecurity.” To add to this, the four-week moving average of new claims for state unemployment is at the highest level since October 2005, and the University of Michigan[1]s consumer sentiment index is marking its lowest point since February 1992 when the economy was emerging from a recession.

I would like to know what the president[1]s fundamentals are. The White House seems to be isolated from reality. Data provided by the Mortgage Insurance Companies of America trade group clearly states that U.S. foreclosure rates have risen to their highest since at least World War II, and defaults on privately insured U.S. mortgages have risen 37 percent in December from the same month a year earlier. RealtyTrac Inc. is reporting that foreclosure rates have risen 75 percent in 2007, and the number of homes that have been repossessed, or taken back by the bank, have jumped 50% nationwide last year. According to The National Association of Realtors Pending Home Sales Index, pending sales of previously owned homes have fallen a steeper-than-expected 1.5 percent in December, and prices of existing U.S. single-family homes have slumped 8.9 percent in the fourth quarter versus a year earlier, the largest decline in the 20-year history of a national home price index. The National Association of Realtors has also reported that sales by homeowners have fallen in January to their lowest reading since the group began reporting annual sales pace in 1999, something which Northern Trust chief economist, Paul Kasriel describes as [3]more doom and gloom.”

To add to this, home prices continued their plunge during the last three months of 2007, setting a real estate trade group’s record for the biggest-ever quarterly drop, the steepest ever recorded by the National Association of Realtors (NAR), which has been compiling the report since 1979. A Merrill Lynch report in January forecasted price declines of 15% in 2008 and another 10% in 2009 before markets begin to recover. On top of this, mortgage applications volume tumbled 22.6 percent during the week ending Feb. 15 according to the Mortgage Bankers Association’s weekly application survey, while Standard & Poor’s Ratings Services said its rating outlook on US homebuilders remains emphatically negative and it believes a recovery is not yet in sight, as six of the nation’s largest mortgage lenders have temporarily stopped foreclosure proceedings, in a joint effort to cool the raging foreclosure crisis through a project known as Project Lifeline.

Things are so bad in the housing sector, a sector which one would deem as part of the fundamentals of a sound economy, that in a conference call with analysts, Kenneth Lewis, the chief executive of Bank of America, pointed out that more borrowers appear to be giving up on their homes as prices fall, noting a “change in social attitudes toward default.” Not surprising considering that CIBC World Markets forecast U.S. house prices will end up sliding 20% before the market stabilizes, and estimates 50% of U.S. homeowners who took out below-prime mortgages in 2006 will end up owing more than their house is worth. As Michael Englund, chief economist at Action Economics put it, “there seems to be a sense of a very deep-seated collapse in the economy.”

The Philadelphia Federal Reserve’s index of manufacturing activity in the U.S. Northeast also indicated the same disparity between Bush[1]s sound fundamentals statement and reality, showing the manufacturing sector in the key heartland of the US is suffering its lowest output for seven years. “As far as this indicator is concerned, a recession, and a severe one at that, is already underway," said Paul Ash-worth, of Capital Economics. For Merrill Lynch, the collapse in the outlook for activity six months out was even more worrisome since it posted the steepest decline in the 40-year history of this report.

America[1]s "new business cycle" which began in the 1980[1]s has created as Thomas Palley ex Chief Economist with the US-China Economic Security Review Commission puts it, large trade deficits, manufacturing job loss, asset price inflation, rising debt-to-income ratios, and detachment of wages from productivity growth. It has used financial booms to support debt-financed spending, an easing of credit standards to support borrowing, and cheap imports to ameliorate the effects of wage stagnation. As Palley puts it, with "debt burdens elevated and housing prices significantly above levels warranted by their historical relation to income, the business cycle of the last two decades appears exhausted.[2]

According to the New York Times, the sound fundamentals Bush likes to refer to, are alarmingly parallel to the [3]Japan[1]s lost decade[2], when the Japanese economy after a long boom in the 1990[1]s, was stopped by a sharp fall in the real estate market causing a stretch of stagnation which ended only a few years ago. Clyde V. Prestowitz, president of the Economic Strategy Institute in Washington, says [3]the American economy is very fragile now," a sentiment which is echoed by Nouriel Roubini, an economics professor at the Stern School of Business at New York University, who warns that "the roughly $100 billion in bad loans reported by banks to date could increase nearly tenfold, as the defaults spread beyond the subprime mortgage loans to consumer loans, credit cards and corporate lending."

European Central Bank council member Guy Quaden points out that "it is clear that the slowdown in the U.S. will be more pronounced than previously foreseen." According to Bank of Italy governor, Mario Draghi, in the meeting held in Tokyo by the finance ministers and central bank chiefs of the Group of Seven industrialized nations, "Bernanke said that while house prices are falling, they can't say how long and deep the crisis will be." But as lawmakers, politicians and bankers continue to debate about the current state of the American economy, what is clear is that the latest consumer price index (CPI), the government's main inflation indicator shows that for the year ending in January, all prices were up 4.3 percent. Excluding the temporary surges after Katrina, inflation hasn't been higher since July 1991. As for the producer price index, year over year the PPI is up 7.4% the fastest pace since 1981. As Robert Brusca, chief economist at FAO Economics says, with this data at hand, [3]it will be hard for Mr. Bernanke to testify…and hold to the fiction of inflation as under control and the Fed as master of tamed inflation expectations." Yet Bernanke is telling lawmakers that `[2]inflation expectations appear to have remained reasonably well anchored,[2] and George Bush is convinced that fundamentals are in place.

As for now, while talk of subprime exposure has diminished, Ted Wieseman, an economist at Morgan Stanley, warns that [3]investor worries about potential further writedowns are shifting in a big way from subprime residential mortgages to commercial real estate lending.[2] Also as major retailers reported chilly January same-store sales, Wal-Mart with a meager 0.5% increase, Target with a 1.1% drop, Macy's with a worse-than-expected 7.1% decline, Kohl's with an 8.3% plunge and Nordstrom with a 6.6% drop in comps, the National Federation of Independent Business said its index of small business optimism slipped to the lowest reading since January 1991, when the U.S. was mired in recession.

To add to this economic and social carnage, Macy's Inc. has reported that it plans to cut 2,300 jobs across the country, Hasbro Inc the second-largest U.S. toy company, expects a

14 percent to 15 percent increase this year in the costs of made-in-China products, Time Warner has reported a 41 percent decline in fourth-quarter profits, Office Depot a 85% plunge in profit, and Jeffrey Garten, professor of international trade and finance at Yale School of Management has said that the United States "is beginning to look like a bargain-basement."

Of course, if the world¹s economic engine looking like a bargain-basement is a reflection of sound fundamentals, then I must accept my misreading of today¹s economic reality and subscribe to George Bush¹s sound fundamentals equation.

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