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Deep problems plague U.S. economy, stimulus plans notwithstanding

By Kevin G. Hall | McClatchy Newspapers

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WASHINGTON — The economic growth package being prepared by President Bush and Congress may help ease the sting of an economic downturn or soften the blow of a recession, but it won't fix the deeper structural problems that are menacing the economy.

That's because the U.S. economy has rarely faced such a combination of challenges all at the same time.

First, the economy is mired in what arguably is the worst housing slump since the Great Depression.

Just last August, President Bush told economic reporters that he saw a "soft landing" for the housing sector. On Friday, Treasury Secretary Henry Paulson offered this grimmer view: "This market needs to correct. We've had unsustainable growth for some period of time. We're not trying to prolong that — it needs to correct."

New housing starts in 2007 fell 24.8 percent to their lowest level since 1980; building permits fell 25.2 percent. Median home prices in hard-hit

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California fell more than 15 percent last year, and no one's quite sure where the bottom is there or in the other troubled states such as Florida and Nevada.

Related problems in housing finance have spilled over, infecting the broader credit markets and roiling Wall Street. Because investment banks packaged mortgages into special bonds sold to investors, they're taking it on the chin now that the housing market is sinking.

Mammoth investment banks Citigroup and Merrill Lynch this month respectively announced fourth-quarter losses of $10 billion and $9.8 billion, respectively, and write-downs of $18.1 billion and $11.5 billion for bad bets made on mortgage-related bonds.

Now, the other shoe may be dropping.

Fears are mounting that insurance companies, which issued policies to protect Wall Street firms from losses on those mortgage bonds, don't have enough money to pay up. The foundation on which housing finance rests is becoming ever more unstable.

If that weren't enough, oil prices flirted with all-time highs this month, and inflation, which erodes the earning power of an American paycheck, remains a hair away from being problematic.

The U.S. economy is resilient and has withstood tremendous headwinds. But many mainstream economists, including former Federal Reserve Chairman Alan Greenspan, now believe that the chances of recession are 50 percent or better.

"I think it's going to boil down to the unemployment rate. If it keeps rising, it's going to undermine spending," said Mark Zandi, the chief economist for Moody's Economy.com, an economic forecaster in West Chester, Pa. "The difference between a weak economy and recession is jobs, and they will be evaporating if unemployment is rising."

Much of today's uncertainty rests on December's weak job growth of only 18,000 jobs. Other economic indicators showed signs of a slowdown, but until December, job growth was steady — a fact that had been cause for relief.

Now, if anemic job growth continues, it would signal recession.

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Ken Goldstein, a veteran labor economist with the Conference Board, an economic research group in New York, said the December job tally sobered people.

"The question is how bad a hit will consumer confidence take because of this," he said.

Consumption drives roughly two-thirds of the U.S. economy, so the jobs question is important. People with jobs spend money. People without them, or afraid that they'll lose theirs, don't.

That's why although the stimulus plan being drafted in Washington seeks to get cash into people's hands, Goldstein doubts that it'll have much impact.

"People are in a mood that ... if the refrigerator isn't broken, we're not going to replace it right now. If the sofa has four legs, we're not going to replace it right now," he said.

Only greater certainty about the job market will revive consumer confidence.

"I think anything north of 75,000 (new jobs) a month is unrealistic. I think 50,000 to 75,000 (jobs) is possible. I would say that 25,000 to 50,000 is all we're going to get," said Goldstein. "There's no reasonable expectation that the labor market is going to be strong for at least the next 16 months."

If the U.S. economy enters a mild recession, it likely would reduce demand and thus drive down oil prices. After flirting with $100-a-barrel prices on Jan. 2, contracts for future delivery of crude oil have fallen to $90 and seem ready to settle below that.

The dollar's plunge against world currencies over the past year has boosted U.S. exports and offset the drag from housing. But it also raises the price of imported consumer goods, pushing up inflation. Inflation in 2007 — 4.1 percent — was the highest since 1990.

Core inflation, which strips out the more-volatile food and energy prices, remains at the upper end of the Federal Reserve's comfort zone, and if it doesn't subside, it could limit the ability of the Fed to lower interest rates aggressively to spark economic activity.

"You look at those core rates ... they are where another notch up would

be problematic," said Martin Regalia, the chief economist for the U.S. Chamber of Commerce.

But the biggest problems, he said, have no simple solutions.

"Over the next year, the biggest problem to get over is the housing and credit markets and the fallout from that," Regalia said. "The best way to do that is keep the economy growing and let it work its way out."

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All this is thanks to the VooDoo Economics from the neo-conservative (nearly Fascist) Bush Administration's "Let Them Eat Cake" attitude. A little revolution is good, is it not?