

Slip Slidin' Away

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The Fed cut interest rates on November 6. It was an uncharacteristic gesture. After nearly a year of watching and hoping that the economic recovery would catch and grow, Mr. Greenspan had to concede to the views of his less optimistic colleagues and lower rates. There is more than a hint of panic surrounding the decision. Rates are now as low as they have been in forty years, and while this may be good for real estate, it suggests that we are in uncharted territory with this economy.

Pessimists are suggesting that the American economy is heading down the same deflationary path that now plagues Japan. They point to low interest rates, declining rates of inflation and weak business investment. They say that the economy is headed into a downward spiral that has all the attractive power of a black hole.

But they are wrong. Japan is a rapidly aging, overregulated economy which values its customs over its economic survival, and therefore cannot change. The U.S. has a population structure ideal for long term growth, and has removed government as a significant force in most industries. Most importantly, we are all about change and our market structure will adapt to any set of circumstances in order to thrive. In short, we are not them nor will we be.

Far more likely is the prospect that the economy will slip back into recession in 2003. Growth is sufficiently weak that any negative push will create the double dip. War is one such push. The economy stopped dead in 1991 during the Gulf War, but that war was so short that the economy was not greatly affected. Consumer spending, though, is the real Achilles heel of this economy. Consumption makes up 2/3 of all economic activity. September sales were down from last year, and October was flat. Right now, most analysts expect holiday retail sales to be up 2.5 percent from 2001. Watch this carefully. If we hit this number, the economy will grow, albeit slowly, in 2003. Much less than that and the danger of recession increases. If you want to forecast where the economy will be in 2003, watch the holiday sales numbers.

With the last interest rate cut, monetary policy is dead as a tool for regulating this economy. What help we need must come on the fiscal side. With the recent election, this is clearly the Bush economy. It's eerie. At the midpoint of his term, President Bush the Elder won acclaim for fighting a victorious war against Iraq and seemingly sewed up a second term. But then he could not revive a shaky economy. Although the Democratic Party was then in disarray, two years later it won the presidency on the back of a then obscure Southern governor. Now that exact set of circumstances faces President Bush the Younger. We can be fairly certain that he will repeat his father's foreign policy triumphs. Will he then repeat his father's domestic mistakes?