



Depression *or* Recession?

By Danny Sedjati

Is the US economy heading to a ***depression***?

- The Dow Jones Industrial Average (DJIA) lost 89% of its value from its peak in 1929 to its bottom in 1932. As of mid November, the DJIA has fallen 40% from the peak of October 2007. DJIA then fell around 50% post 1929's peak after a good year and one month. Although the equity market could fall further in the coming months, the likelihood of an 89% drop is futile.
- Real disposable income per capita fell 28% from 1929-1933 and dropped 9% from 1929-1930. As of September 2008, real disposable income per capital declined to 0.9% from a year earlier, which was the weakest since 1991. Thus, it is safe to say that a 9% decline in real net income in the next year is minimal.
- Today's unemployment rate is 6.5% as compared to the 19% rate during 1931-1940 with a peak rate of 25.3% in 1933. Today's rate, is no comparison to that of the Great Depression.

The "D" word creeps to everyone's mind whenever equity market plunges and unemployment rate rises. In the past, people have always compared such occurrence with the extreme stage of "Great Depression".

A "depression" with scale as great as that of 1929 scale would not occur exactly the way it did then. Central banks around the world, including the U.S. Federal Reserve, are so much more aware of the importance of monetary policies in regulating the economy now. However, there is only so much monetary policies can do to offset fiscal policies.

The incredible size of the U.S. current account deficit and national debt could possibly trigger an economic panic, causing difficulties for monetary policies to take affect. No one really knows due to the current unprecedented U.S. debt level. The U.S. economy has been living on borrowed money for a very long time, and the economy is now experiencing the unwinding of such excess. Yet, such unwinding might not be powerful enough to disarm the entire growth of global economy.

Despite the fact that our current economy is far from “rosy”, it is highly unlikely that we are entering the Great Depression yet again.

Is the US Economy in *Recession*?

The National Bureau of Economic Research defined a recession as a significant decline in economic activity that spreads across the economy, lasting more than a few months, normally visible in real GDP growth, real personal income, employment and retail sales. Based on this definition, we are currently in a recession.

The recession we are currently facing started from an abundance of credit distributed to the real estate sector. Over time, such credit became increasingly difficult to obtain not just within the real estate industry but to others as well, creating a global panic across countries. The government started initiating bail-out plans while some companies began reverting to bankruptcy. As the equity market plunges each day to new lows, consumers continue to lose confidence in the economy. Spending is cut, leading to massive layoffs in not only financial firms but also manufacturing, auto, retail and others. This disruption has created even more negative effect in buyers' confidence. Retail sales were down 2.8% in October from September, and 4.1% from a year ago as consumers turn pessimistic and cutting their spending even more. The U.S. Commerce Department estimates that the U.S. economy, as measured by GDP, declines by 0.3% in 2008's 3Q.

How Long Will It Last?

- Late 2000's recession (October '08 – current): caused by high fuel prices and credit crisis
- Early 2000s recession (April '00- October '01; **18 months**): caused by collapsed dotcom bubble, September 11 attack and accounting scandals.
- 1990's recession (July '90 – April '91; **10 months**): caused by decrease of industrial production and manufacturing sales.
- 1980's recession (April '80 – October '82; **30 months**) caused by tight US monetary policy to control inflation created from the '79 energy crisis.
- 1953 recession (April '53 – April '54; **12 months**) caused by tightened monetary policies that were adjusted to be more restrictive to curb inflation.

Recession period varies. Historically, recession cycles last an average of 14 months. The upside of this is perhaps the expansion period - 4 times longer than the recessionary period.

After every recession there is always an expansion period. Conversely, after every expansion there is a recession. As long as there is an economy, this cycle will always

exist. Underneath all the bad news we constantly see, there are glimpses of good news that will turn the ship around. The US government is establishing plans to create more jobs and credit accessible for businesses, so they can sustain its operation. The global economic turmoil has also led other countries to create its own stimulus package in order to maintain commerce. These initiatives will help steer the economy out of the recessionary period we are facing now.

Recovery

Fixing the current US recession needs to begin with the stabilization of the housing market. We have seen unprecedented declines in house prices fueled by myriad inventories. The latest Case-Schiller index shows nearly 17% decline in price over the past year, signaling that the bottom is near. This, coupled with low mortgage rates will make real estate once again affordable.

Demand for real estate is not the only factor that will drive our economy out of recession. Credit market must also be restored to drive consumer spending and businesses to grow. Although it could take quite some time for the financial industries to write off all toxic debts, the government seems to consistently come up with promising plans to ease the market.

We are also seeing consumer cutting back in spending and postponing major purchases, which is normal in a recessionary period. However, we need to understand that while they are not spending, they are still consuming. Over a period of time, consumer goods will start to wear out. Cars, machines and appliances with continuous usage and constant repair will eventually need replacements. Economists have referred to this phenomenon as a "*pent-up demand*".

On October 3, 2008, US Treasury Department moved to propose a Troubled Assets Relief Program (TARP). The \$700 billion fund was created as a part of a rescue plan intended to inject liquidity back into the market. Another stimulus package, this time, a possible \$800 billion is being proposed by the new president elect- Barack Obama. In the global arena, the G-20 leaders in the November G-20 Summit promised a broader policy response and have begun working on financial plans to be delivered on an upcoming April 2009 meeting. As positive news start to flow increasingly, we will see the capital market returning to normal condition, lifting consumer confidence, and fueling consumer spending.

There is no question that we are facing another recession. However, with all the bailout plans already in place and additional plans to carry out next year, a recovery is bound to occur. We are guessing the bottom will emerge by the 3rd quarter of 2009, followed by a gradual expansion.