Some Dare Call It a Recession

A September 19 *New York Times* article quoted Michael O'Neill, a vice president with American Express, concerning the credit card giant's new policies in response to financial market conditions. O'Neil explained that his firm regularly reviews customer accounts for credit worthiness. Upon review, typically the credit limit for three-fourths of its customers increased, and decreased for one-fourth. However, American Express initiated stricter practices in July, and O'Neill said of the new ratio: "The tilt is 50-50."

Though government agencies have thus far abstained from using the word "recession" to refer to current economic conditions, the phrase is beginning to creep into the vocabulary of financial experts quoted by the media. For example, in a recent *Times* article, Ethan Harris, the chief domestic economist at beleaguered Lehman Brothers, stated: "We have moved into a decline in consumer spending, which normally happens only in a major recession." Harris referred to the experience as "a slow-motion recession in which economic growth will be near zero for an extended period of time."

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Along with the decline comes more stringent standards for granting credit, according to Harris. He said: "More and more, [credit card companies] don't give the [credit] card if you don't have a good credit record."

This trend was confirmed by Brad Rock, chairman of the Smithtown, New York, bank and also chairman of the American Bankers Association, who said: "Now people are going to actually have to have a job to get a loan and they are going to have to make installment payments that are already higher per dollar borrowed than they used to be."

The dreaded "R" word also appeared in a September 18 Reuters news report, which bluntly stated: "The U.S. economy is likely slipping into a mild recession and hard hit financial markets and firms will need an injection of public funds to restore confidence, a group of bank economists said on Thursday [September 18]."

The economists referred to were the Economic Advisory Committee of the American Bankers Association, whose chairman, Peter Hooper, predicted: "It is going to be an uncomfortable several quarters to go from a macroeconomic standpoint."

Hooper summarized the forces putting a drag on the economy: "What we are facing is a housing market continuing to decline, home prices still falling, [and] great uncertainty still about the valuation of assets in certain parts of the banking sector as investors require more capital."

Hooper called for more government bailouts as the answer, stating: "We think the substitution of sovereign debt for private debt is ultimately what's going to be helping to rebuild confidence until we can work out over a longer period of time the selling off of stressed assets."

It was the first time we had encountered the expression “sovereign debt” as a euphemism for what would ultimately be debt incurred by U.S. taxpayers.

The day after Hooper made his statement, President Bush, flanked by Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke, revealed a plan to have the federal government purchase virtually worthless mortgage-backed investments. Additionally, the Securities and Exchange Commission enacted a temporary ban on the short-selling of nearly 800 financial stocks.

Bush acknowledged that the program will put a “significant amount of taxpayers’ money on the line.’’

Chris Dodd, (D-Conn.), the chairman of the Senate Banking Committee, warned on ABC’s *Good Morning America* on September 19, that the United States could be “days away from a complete meltdown of our financial system." He told viewers that Congress would work quickly to intervene.

Joining Dodd on *Good Morning America* was Sen. Richard Shelby, (R-Ala.), the top Republican on the Senate Banking Committee. “I figure it’ll be at least a half a trillion,” responded Shelby when asked about the cost of the bailout. “But when you look at what the Fed has already done, and the extension of power to Treasury to deal with Fannie Mae and Freddie Mac, I believe we’re talking about a trillion dollars.”

Shelby continued: “We know $500 billion or $1 trillion, that’s a lot of money. And sooner or later it’s going to visit the taxpayer. Sooner or later it’s either going to be a debt charged to all of us [or] to our children.”

Though the stock market reacted favorably to the government plan, serious questions have been raised about the long-term effects of such nationalization of private debt. An online article by financial analyst and journalist Henry Blodget, observed:

> Not surprisingly, the market’s up huge on this news. The moves should head off a run on money-market funds, restore liquidity to the financial system, and, as bank analyst Tom Brown puts it in the accompanying video, create a general “time out” for the panic to recede.

So what are the costs? Almost certainly:
• Higher taxes
• Higher interest rates on government debt
• Bigger government deficits